JOB CREATION AND THE REVITALIZATION OF SMALL BUSINESS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TAX, ACCESS TO EQUITY CAPITAL AND BUSINESS OPPORTUNITIES

OF THE

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JOB CREATION AND THE REVITALIZATION OF SMALL BUSINESS

TUESDAY, SEPTEMBER 15, 1981

House of Representatives,
Subcommittee on Tax, Access to Equity
Capital and Business Opportunities,
Committee on Small Business,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2359-A, Rayburn House Office Building, Hon. Henry J. Nowak (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN NOWAK

Mr. Nowak. The subcommittee will come to order.

Let me apologize for being late. The airlines have a particular problem these days as well as many other industries. We felt that we wanted to continue with these hearings even though we started late and we will hear all the witnesses no matter how long it takes.

Today we begin the first of 3 days of hearings that will focus on job creation and the revitalization of small business. Since it is well established that small business creates the vast majority of new jobs in this Nation, the subcommittee will explore such issues as the impact of skilled labor shortages on small business and the need for viable economic incentives for our older urban centers.

The current debate over tax incentives for distressed areas promises to provide a measure of relief to areas suffering from long-term economic deterioration. However, we must take a realistic approach to this problem and recognize that tax incentives alone will not cure our urban problems.

A business will derive no benefit from tax credits and deductions if it is not making a profit. Therefore, a startup business, which often has little or no profits in its early years, must look for other ways to meet its capital formation needs. In many instances, these needs can only be met through viable loan and venture capital programs.

Another problem which we must address is the need to improve the infrastructure base of these distressed areas. In order to encourage the business community to locate and remain in our urban centers, we must provide for such needs as efficient sewer and transportation systems.

With respect to skilled labor shortages, it is important to recognize that a growing job void will be created as businesses move toward increased automation. Experts have projected that 45 million existing jobs could be affected by factory and office automation. This potential displacement of workers will require the implementation of training programs to teach individuals the skills necessary for utilizing the new technologies.

In addition, the current plans of the administration to increase defense spending will intensify the problem and place a greater burden on industries presently facing an acute shortage of qualified skilled workers. Without a sufficient supply of skilled laborers, many industries will be unable to increase their output to meet current demands. A prime example of this situation is the machine trades. Irrespective of the increase in defense spending, the machining occupations have projected that they will have more than 44,000 annual openings.

This subcommittee will continue to work toward providing small business with the proper economic incentives for relieving the unemployment and urban problems of our Nation.

At this time I would like to call upon Dan Marriott who is taking a very broad and vital view of this whole area and has contributed greatly to our subcommittee hearings in the past. We look forward to his input in the future. Mr. Marriott.

Mr. **Marriott**. I would like to insert in the record a statement I prepared and simply say I look forward to these hearings. I congratulate you on holding these hearings. I hope we can make the enterprise zone concept of Congressmen Kemp and Garcia work. I think there is real possibility. I have been an advocate of increased tax credits for small businesses and others to help revitalize our cities and I hope today we can come out with some information and ideas that will help us turn things around.

Mr. **Nowak**. The statement will be inserted in the record, without objection.

OPENING STATEMENT OF HON. DAN MARRIOTT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF UTAH

Mr. **Marriott**. Mr. Chairman, first, I would like to thank you—and commend you—for calling these most important hearings.

As you know, the proposal to establish enterprise zones in the inner cities was adopted as a plank in the 1980 Republican platform. At the same time, the proposal enjoys wide bipartisan support; legislation to implement it was jointly introduced by Congressmen Jack Kemp, a conservative Republican, and Henry Garcia, a liberal Democrat.

As Heritage Foundation scholar, Stuart Butler has observed, "It is quite natural for towns and cities to alter over time, in size, structure, and importance." In this Nation, cities have declined as they became less desirable as a residence or place of employment. Unfortunately, such a tendency snowballs—the more people who move, the smaller the tax base, the greater the strain on public services, the worse living conditions become, the more people move, and so on.

I would seriously hope that these hearings will not only address the question of whether we ought to do anything to artificially halt this trend—I think we should. But, I would hope we will also examine the extent to which misguided, paternalistic Government measures actually contributed to this decline. And, I am confident we will be able to suggest ways in which these districts can be revitalized without adding to the already unreasonable burden of the American taxpayer. Indeed, I think the enterprise zone concept offers an opportunity to turn the situation around in such a way that the cities will become important contributors to the country's growth in such a way that it will actually relieve the taxpayers' burden.

I firmly believe that all Members of Congress owe it to themselves and to their constituents to join us in discussing the plight of the inner cities, to consider what Dr. Butler calls the "disappointing results of decades of Government projects," and to examine the change in thinking that has gone on in this area in recent years.

I understand that Dr. Butler will be with us next week. I look forward to hearing him discuss the evolution of the enterprise zone concept and the practical evidence supporting it. I am also anxious that we not gloss over the subject. There have been a number of objections raised against the concept. It is important that we give each of these serious consideration to determine their validity. Finally, I hope this subcommittee and the witnesses who have joined us will be able to provide some important insights and suggestions for the direction of future policy in this area.

Thank you.

Mr. **Nowak**. Our first witness this morning is Congressman Don Bailey, a Member of Congress from the Pittsburgh area who is currently serving on the Ways and Means Committee, a committee that has some important jurisdiction in this country. It is one of the committees that this subcommittee has worked with in the past and we look to work with in greater detail in the future, in order to bring about the correct kind of stimulus to accomplish a revitalization of small business and urban centers. It is with a great deal of pleasure that we bring Mr. Bailey here. He is certainly one who has participated in the tax debate and has introduced H.R. 3752, the Critical Industrial Reindustrialization Tax Act of 1981 which has been the focus of a means to cure the skilled labor shortage or at least alleviate that problem in this country.

It is with a great deal of pleasure we welcome our colleague before us.

TESTIMONY OF DON BAILEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. **Don Bailey**. First let me express my appreciation to you and the subcommittee for holding these hearings. Unfortunately issues like this are sometimes dealt with in a cursory fashion in the Ways and Means Committee. It is an extremely vital area and it is one on which public attention needs to be focused. I will be brief for two reasons: One, some of the information I have and would like to present to you is perhaps tangential although I think it goes to the basic issue with which you are concerned; second, the National Tooling and Machining Association that has more detail will follow me today. They have been very cooperative in helping me collect information and they have done a great deal of work and were instrumental in putting together the piece of legislation. It was basically their core idea upon which I made a few changes and introduced the legislation they are going to discuss.

When I was on the Armed Services Committee, where I served before I went to the Ways and Means Committee, I served on a panel chaired by Dick Ichord, a Member from Missouri who is retired now. We were very much concerned with the country's industrial base and the relationship of that industrial base to our defense capability. The panel was appointed by Chairman Mel Price and I was privileged to serve on the panel. We issued a report—that was the 96th Congress, second session—December 31, 1980, "Defense Industrial Base: Unready for Crisis."

I think that our aims are best served here if I could read from the skilled labor section an excerpt of how severe this problem is.

On page 11 of the report, "Discussion of Findings" they find, point No. 5: "Skilled manpower shortages exist now and are projected to continue through the decade." Since I helped compose this section I would like to enter it in the record and read it.

> Critical manpower shortages. The panel found that skilled manpower shortages are prevalent throughout industry. The Defense Science Board task force concluded that a major contributor to the increasing lead times and costs currently afflicting the defense community is a continuing shortage of skilled labor. Mr. Fuhrman painted a less than promising picture when he stated that: "Our study indicates the Nation would be short 250,000 machinists in the next 5 years. We did not see any overall Government programs aimed at solving this problem, and the individual company training efforts were only touching the tip of the iceberg. In spite of the recession and its attendant unemployment, there remains a shortage of the skills needed by the defense industry. The shortage leads to competition for labor and an upward pressure on costs.

Mr. Church echoed Mr. Fuhrman's concerns when he stated:

> The skilled manpower problem is probably one of the most difficult nuts to crack of these problems, particularly when we are trying to do it from a defense perspective.
>
> As the panel's investigation proceeded it emerged that manpower shortages penetrate deeply into the lower tiers of the defense industrial base. Several of the subtier contractors indicated that while they have reserve equipment and capacity, their ability to surge is crippled by limited manpower.

Mr. Chairman, at this point let me say there is a tendency to be preoccupied with some type of nuclear exchange in a modern day war scenario. It does not leave much room for differentialities about what we have to face as a country in military or economic competition with other nations. In all likelihood under that nuclear umbrella the things that can happen involve strains on the Nation's industrial and economic capacity. We don't have the ability to go out there in 6 months or 1 year and meet the requirements of a surge defense should we get into a limited or subnuclear type of conflict worldwide. In all likelihood, that is the kind of confrontation into which we would get as opposed to the ultimate button pushing scenario.

Mr. Church told the panel:

> I think that we ought to be able to choose from the whole base of high school graduates, or whoever would like to be a skilled machinist, because we are falling 75-percent short of those needs to merely take care of the loss that we are seeing on an annual basis. So we should turn over every stone. Wherever we can find a person, we have got to use them.

The panel did not examine the capability of the U.S. educational system to satisfy the manpower demands of the defense industrial base, particularly in the skilled trade areas. The panel suggests that the role of the U.S. educational system and its impact on the preparedness of the defense industrial base be reviewed by the Committee on Armed Services and other appropriate House committees and the Department of Defense.

The panel believes that the solution to this national manpower problem will require a national commitment. Further, unlike World War II, when under full mobilization, thousands upon thousands of people—farmers, housewives, construction laborers, clerks, and others—answered the call to arms and poured into our defense factories, the current economic environment and weapons system sophistication will not support any quick fix or emergency manpower reallocation to satisfy surge requirements.

Mr. Gray made this point when he stated:

> Building the plant and getting the equipment are only part of the job. During the Second World War, we brought in people who never before had worked in a factory—farmers, clerks, housewives. They were trained in a matter of weeks to build aircraft engines. And they built thousands of them. Today, however you can't just take someone off a farm or out of a kitchen and expect him or her to build aircraft engines. The technology is too advanced, the tolerances too tight, the equipment too sophisticated. It takes 3 years for a machinist apprentice to complete his rigorous course. It takes the better part of 1 year to retrain someone from producing autos, for example, to work on high technology aerospace parts.

I might end with this, Mr. Chairman, it has created a sellers market. At the present time the United States is going to begin to have to import people from overseas because we are losing our capacity to train and supply people for critical industrial jobs. The impact of this thing as it spreads into the defense industry is just incredible. The demands that are going to be made by the increased national defense spending that we are going into under the Reagan budget will have a deleterious impact on the Nation's productivity because you will create more of a labor shortage as defense contractors and subcontractors draw off that labor. We have got to meet very quickly a requirement to produce skilled people to meet a national need here. I hope that in the efforts of your subcommittee here that you bring to light those needs and requirements and we will find a way of doing something about it.

Thank you.

Mr. NOWAK. Thank you very much, Mr. Bailey. I think you hit upon a very important area and I am glad you were the leadoff witness because your background certainly indicates a lot of work on this particular subject. Maybe you could touch on your local area of Pittsburgh and tell us what types of industries particularly are impacted by any kind of skilled labor shortages at the present time.

Mr. DON BAILEY. Practically every primary manufacturing facility and its impact on secondary facilities are affected by a shortage of skilled labor. In our area we have a lot of basic steel and naturally there has been a great deal of satellite work done in the areas of second manufacturing. We have automobile manufacturing facilities, Volkswagen of America is in my district. All of western Pennsylvania, Mr. Chairman, is simply dotted with all types of machine shops of various sizes. These training programs are extremely expensive. Part of the problem is the companies are not able to find people that have the basic skills although in my area we have the highest skilled labor force probably in the overall area now in the entire world. At least we are reputed to have that capacity.

We do all kinds of things out there in the manufacturing room and the shortage is just incredible. The money they pay is terrific. We are talking about $45,000 and $50,000 and you are not talking about getting into overtime. We are talking about a kind of person, Mr. Chairman, that has to have a lot of ability to read blueprints. It takes skill. It is a talent. It has to be developed. It takes years to learn it. Mostly we are talking about machinists that simply take a great deal of money to buy. You just can't go out and establish a simple little educational program somewhere and bring people in and have them learn and then go out and find a job. My area is very highly industrialized. We have a severe problem here.

Mr. **Nowak**. When we look at the total urban picture, in the Pittsburgh area, do you believe that the code as we have changed it will spur some development of the private sector and will have a very quick or meaningful impact on the economy?

Mr. **Don Bailey**. Mr. Chairman, my views may be suspect in that regard. It is an outstanding question. I had felt when we wrote the tax bill, the ways and means policy had a great impact on the administration bill. My honest answer to your question is no. I don't think there is enough in there to provide the immediate impact we need without getting into partisan issues of disagreeing over the two major proposals that were made. By the time the advantages of 10-5-3 show up, for example, I really think in cash flow you are talking about 3 or 4 years maybe. At least most of our industry people tell us that. I would specifically like to have seen some changes with distressed industries which unfortunately were modified in the administration proposal by their liberalized leasing provisions that will not target money sufficiently into the kinds of things you are interested in talking about. I also see a lack of appreciation, in the bill that was written and in the code as it exists now, for the kind of things that both you and Congressman Marriott mentioned earlier. That is the use of the tax credit as a vehicle to specifically target help and encourage development of certain kinds of labor. We have out there an extremely cultural point of view, a large number of very hard-working types of Americans. They come from all over the world, middle and eastern Europeans with tremendous skills. We have developed a fantastic work force out there that is like none other anywhere in the country in my opinion. I am prejudiced but we don't have the means to get those people into the work force and get them working. The present code does not sufficiently do that, Mr. Chairman in my opinion. It has made some steps in the right direction but not enough. Certainly not rapidly enough.

Mr. **Nowak**. Thank you very much. Mr. Marriott?

Mr. **Marriott**. Congressman, I enjoyed your testimony. Let me ask you this question: How could these problems be best solved? Is this a university educational system problem? We are graduating lots of bankers and social workers and all of this. It does not appear to me that there are people who understand the potential for these areas. Do we have a failing in our educational system? Is that why we have a shortage of manpower? Is it a capital formation problem? How do you identify the single major problem and how we go about solving it?

Mr. **Don Bailey**. I don't know if there is a single major problem. Except what I say as someone who has a viewpoint but not the expertise of some of your witnesses who will be testifying. I think it begins in our public educational system in our approach to vocational education in the first place. We could get into all kinds of things in terms of cultural attitudes but there are a lot of people that think we are not doing a good basic job. One, with the kind of skills we need to produce those kinds of people, mathematic skills, presenting opportunities and chances for people to get into these kinds of programs. Two, is an issue of cost. You are talking about extremely sophisticated equipment in some cases where a person has to work on that equipment for a while, work under a skilled craftsman. It has to be OJT—on the job training—in a lot of cases. You might say in that case why can't a company go out and establish a program and get the kind of people they need. The need to go out and pick among a lot of qualified people to get the best people for these skilled jobs.

You might call some of these people artisans. They are. They require great skills to use that machinery efficiently and to use it in a cost-effective way. To answer the second part of your question about how you solve the problem—you cannot set up a machine shop to teach these people. The costs would be absolutely prohibitive. I don't know how you could fund it. You can teach basic skills, academic and machining skills and that is done. You have a program for doing that. I am working now with Allegheny County Community College to develop a program to get them into exactly that kind of vocational thing, but Uncle Sam is not doing much to help. State resources are not adequate as you know.

Mr. **Marriott**. That is the point.

Mr. **Don Bailey**. The short line would be some type of job tax credit that focuses on the skilled manpower need, perhaps in some program that will provide a certification, Department of Labor, Department of Defense, if you want to tie it to defense. I would not want to tie it to defense. I would say a job tax credit would be the answer.

Mr. **Marriott**. Let me go to vocational education. We don't do much in Congress to fund that. It is a low priority in some States, despite a lot of money in colleges and other facilities. Is part of the answer an increased funding for vocational education and putting that on a higher priority listing?

Mr. **Don Bailey**. I strongly think it is.

Mr. **Marriott**. So better vocational education programs and job tax credits, you think, would go a long ways to solving the problem?

Mr. **Don Bailey**. Congressman Marriott, yes I do. Let me say this. The community college structure I think is a ready made community relation, geographic dispersion type of vehicle, at least in the State of Pennsylvania, for solving that problem. I think we have the institutions there. We don't have the programs to utilize them properly. I think that would be an excellent way to go. I never introduced legislation on it specifically but it is something I think is the second part of the problem. The other thing, use the job tax credit so at the individual site the certification requirements and apprenticeship programs will be developed where you have that expensive machinery, that large machine shop to develop skilled labor.

Mr. **Marriott**. Do you have any idea what the cost is to train one good skilled laborer in this $40,000 to $50,000 salary category?

Mr. **Don Bailey**. I don't have a figure on what it would cost in an individual laborer's case. You would have a tremendous variation depending on the skill. If I tried to put a price tag on one job I think I would probably do violence to it. But let me say this. As far as the tax credit side of the proposal is concerned—it means this and I don't think it is a conservative figure, in fact it is a fat one—if you went out there and spent one-half of a billion dollars or began a program to spend one-half of a billion dollars and used the tax credit vehicle I think that you would have a great leg up on solving the problem. You can make a big dent if you spend $300 or $400 million. That is not a whole lot of money for what this brings in productivity. That is what we are forgetting. It is a different subject. This is one of the areas where we are going to be so short of technicians we are in serious trouble. As far as individual jobs, I can train somebody in a machine shop in Volkswagen perhaps for a relatively low figure because that employee at certain stages can be a productive money-earning employee. They are helping to earn money. They are providing economic return to their employer but I can go to the machine shop in Alcoa and that company could get into a $250,000 investment and that guy's training may not pay off and you may have a problem. It depends on the situation in the machine shop and what you are trying to achieve.

Mr. **Marriott**. Thank you.

Mr. **Nowak**. Thank you, Congressman. We hope we will have the opportunity to work on this problem with your office. We will give you an indication as the testimony comes in and try to keep your staff up to date as to the information that we derive. We look forward to developing something that would be of some meaningful help on this problem.

Thank you very much.

Our next witness will be the mayor of the city of Buffalo, Jim Griffin, and the mayor is here. Would he please come up. For the members here, Mayor Griffin is a former State senator who is finishing his first term as the mayor of the city of Buffalo. In a recent primary he has assured himself of a second 4-year term so he is well on his way to providing us with not only his past experience but what he sees in the future for the next 4 years. He has certainly built a reputation in the city of Buffalo and with other mayors of large urban areas in the country as one who has provided great leadership in the economic development area and has, in fact, been responsible for development of a core area in the downtown section. Mayor Griffin developed for the first time since about 1942 a dramatic new housing development on the waterfront, through various and sundry kinds of grants and private investments.

So Mr. Mayor, we are happy that you have taken time to come before our subcommittee and I am sure that the other members will be interested in hearing what you have to say.

TESTIMONY OF JAMES GRIFFIN, MAYOR, CITY OF BUFFALO, N.Y.

Mr. GRIFFIN. Thank you very much, Mr. Chairman and Congressman Marriott for inviting me to testify before you today.

There is a certain amount of irony and urgency in the timing of your hearings. I say irony because it strikes me as somewhat strange and at the same time very sad that it has come to the point in this country where the U.S. Congress must ponder ways to create enterprise in urban areas, which have served as centers for commerce and enterprise for several hundred years. Perhaps their recent decline has a greater significance for the health of the country as a whole than the present administration is willing to recognize.

I also used the word urgency. President Reagan is going to ask the Congress to cut the budget an additional $30 billion in the short run and another $85 billion beginning next fiscal year. The President took a good healthy bite out of the older cities last time around. This time he might decide to simply clean off the plate. It is very important, then, for the mayors and the Congress to develop a well thought out, effective, and efficient urban strategy that the President can evaluate before the budget pressures preempt his consideration.

I want to start my comments with a statement which I may seem to contradict later in my text, that is, I support enterprise zones in concept and believe they will have a very positive and favorable impact on older Northeastern cities.

Mr. Chairman, I feel that the program outlined in your proposed bill, H.R. 2965, mixes enterprise zone concepts with past proven and tried urban programs in a way that is both cost conscious and yet sufficiently funded to be effective. The Nowak bill responds to the real needs of cities like Buffalo.

I recently heard a conservative Congressman state on television that enterprise zones are important because entrepreneurs are often reluctant to start a new business because the Government taxes them to death as soon as they start to make money. I have learned many things since I have been in office and I know that you will never meet a poor owner of a successful privately held company, and no businessman ever turns down an opportunity to make money because he is afraid he might have to pay taxes on it. It is the inability to raise the necessary capital that keeps a product from the market, not taxes. We have accountants to take care of them. Enterprise zones must first and foremost create ways to raise initial seed and expansion capital for inner-city businesses.

Your bill, which ties an allocation of EDA—Economic Development Administration—title IX dollars for businesses loans to enterprise zone areas, insures that new businesses will have the capital needed for their growth. My administration has been successfully using the title IX program in conjunction with HUD block grant funds to provide both fixed asset and working capital financing for expanding companies.

During the last 3 years, the city has lent $8 million to 87 companies which leveraged $38 million in private funds and created or retained 4,737 jobs. Friday we approved 6 more loans for $165,000 which would generate $1,000,993 and create another 125 jobs in the city of Buffalo. The enterprise zone bill must create a direct relationship between these Government-backed loan programs and the new special tax incentives.

There is a maxim that I believe in and that is Government should never do the work of private business and private business will never do the work of Government. No matter how much tax incentive you give to an entrepreneur, he cannot start his business without a street, a sewer, a waterline, a police department, a fire department, and public education.

For business to exist and grow, there must be a basic municipal infrastructure and support services to assist it.

After 150 years of wear and tear, Buffalo, like New York, Chicago, and every other older American city, must spend hundreds of millions in the next few years just to restore its basic system. In light of this financial burden, there is no guarantee that the city can meet the demands of new development let alone service what is there. Therefore, the final version of your bill should include infrastructure dollars from EDA and the city block grant to support enterprise growth.

I have many other thoughts on enterprise zones which we don't have time for today, but I would like to briefly mention one that I wish you would consider. The notion that the job generating activities of the zone must be congruous to impacted residential areas is ill-founded. One of the greatest problems with industry in large cities today lies in the fact that most factories were built 30 or 40 years ago in landlocked, obsolete residential neighborhoods. As companies grew, they were forced to either bear the additional cost of acquiring, demolishing, and developing residential property or to move to a new less expensive site in an attractive suburban environment. Therefore, to avoid the conflict between the growth of industry and the stability of our neighborhoods, enterprise zones should allow for the independent site location of business.

In closing, I would urge the subcommittee to evaluate the concept of enterprise zones in a regional context. More specifically I would like you to ask the question: How does this bill begin to correct the imbalance of aid that has occurred between the Northeastern, Southern and Western States? I mentioned block grants earlier. The distribution formula for block grants allows cities like Houston, which is perhaps one of the richest growing cities in the world, to receive more money than Buffalo, N.Y. Burbank receives more than Lackawanna, N.Y., which has 2,000 unemployed steelworkers. Last year Buffalo was faced with a $14 million operating deficit while Houston, with no State income tax, chalked up a $35 million surplus.

Enterprise zones are a form of Government aid. Although most people view them as simple tax gimmicks, they actually represent uncollected taxes. An uncollected tax costs the Government as much if not more than directly funded Government programs. The final version of this bill should take into consideration that the enterprise zone bill is actually a Federal funding bill.

I would urge you to insure that enterprise zones are targeted to the Northeast and Midwestern cities and do not further perpetuate the funding imbalances that we have in the Reagan program today.

One other issue I would like to mention. Over the weekend there was a story in the paper by Richard Williamson. He was quoted in the Los Angeles Times and in the Washington Post, "It is no secret some people in the Administration believe general revenue sharing is an area to be looked at for further budget reduction." I want to make it known to you that I strongly exempt any possible reduction in a future funding of Federal revenue sharing to cities. The city of Buffalo is having great difficulty in dealing with current cutbacks in Federal programs such as CETA. The loss of Federal sharing would deal a crippling blow to the ability of the city of Buffalo to provide basic service to its residents. In the city in fiscal year 1977-78, Buffalo received $14.4 million in Federal revenue sharing in a recession. Fiscal assistance was eliminated in the city in fiscal year 1979-80 and Federal revenue sharing has been reduced to just over $5 million. The trend must be reversed and increased rather than eliminated; Federal revenue sharing is desperately needed by cities such as Buffalo.

Thank you.

Mr. NOWAK. Thank you very much, mayor.

I want to just make a comment on the statement you made concerning the contiguous so-called industrial zone if one is to be established. I think when you look at the land development possibilities in the city of Buffalo it is readily apparent that unless the zone is broad enough to encompass several types of different kinds of industries you won't have any new business located there because of the land possibilities for development in the city.

When we look at the new industrial parks you have another problem which you also mentioned in your testimony. That is how to develop a piece of property and make it ready for industrial use when it has been lying idle without proper drainage and sewage and so forth. I wondered if the Williams Street Industrial Park and the other areas that you are looking forward to developing as industrial parks in the city will require substantial sums of money either from your budget or the State budget or the EDA which has helped in the past.

Mr. GRIFFIN. You know and I know that the cities cannot afford the expenditure for this capital construction. The city of Buffalo was $6 below the constitutional limit for taxing. The moneys must come from the Federal Government and the State government. I think cities like Buffalo are asking the Congress today to do for the Northeast what they have done for the South in the twenties and the thirties and the forties. We are not asking for any handout. We are saying that we want some of our taxes back that we give to Washington. Without the sewer lines and the waterlines, Mr. Chairman, we would not have the Williams Street Industrial Center in Buffalo.

We need these moneys and we need them now. We are doing a job in the cities, as you see in some of the Federal press. We have not filled 447 jobs in the last 4 years since I have been mayor. We saved over $12 million for the taxpayer but that can go on just so long if we don't get the big capital money from Washington. Our State, and our Governor have been good to the city of Buffalo and other cities throughout the State, but you have to pick and choose when you are dealing with Federal funds. As I mentioned, the city of Houston gets more block grant money than Buffalo. It has a surplus of $35 million. I think you have to listen to the mayors especially in the Northern and Midwestern cities to realize the problems that we have today.

Mr. **Nowak**. One of the areas where I think you have had a tremendous rate of success is in the investment of the Community Block Development Fund and other funds and EDA funds. These went into the leveraging program where you provided front money or seed money to small growing corporations in the city in different types of small- to medium-sized business to encourage them to stay in the city and thus, to offset some of the disincentives to locating in the Northeast and New York, in particular. You have had great success with taking those kinds of dollars. I note with some sadness that a $12 million commitment for $3 million every year to provide these types of low interest loans on a revolving basis has not been forthcoming this year from EDA because of the cutbacks in the EDA program. That meant of course that the 20 or 28 industries and businesses that wanted to use the money to expand their businesses in the city of Buffalo could not do it because that $3 million has not been forthcoming even though the previous $6 million has. Do you feel you have to dedicate other dollars or try to make that kind of additional investment in your own city loan program if that $3 million does not come to Erie County Industrial Development Agency in the future?

Mr. **Griffin**. Mr. Chairman, with EDA funds we set up our local development corporation. Not only did it help in the city but we were one of the first firms in the country to have a minority contracting program; 45 minority contractors in the city of Buffalo. Before 1978 they only received $4 million in construction funding to build on these construction projects. Now they were able to bid on $15 million of construction projects, not only in Buffalo but Erie County and I hired 327 unemployed workers that would be on unemployment insurance or on welfare. You ask where are we going to get the money. If it does not come from Washington it just won't be there. Because we have a problem just making do with our basic services, police, fire, water, streets, and education. We just received word from Washington that Federal aid to education has been cut. Last week we spoke on vocational training. That was one of the cuts. These are the programs that are not the fat. These are the programs that are the meat. These are the programs that are going to make or break the cities of this country.

Mr. **Nowak**. I think in discussions we have had with other mayors and people in your administration, we certainly have made it very clear that the tax package as such is vital. One of the reasons for these hearings was to try to get an overview of what impact the tax program would have and if it would be enough to really revitalize, first, the economy and second, the urban centers of our country. It is clear to me that we must combine the tax incentives with additional types of working capital, because if you don't have any working capital you don't have access to the credit markets because you cannot pay 21 percent to borrow to go into business. If you don't have that type of assets you are not going to be able to even start the business or to take advantage of the tax incentives that are there.

Then, you have to start to make money before you will have any capital formation develop within the company because of the tax incentives that we just passed. The other problem you mentioned—and I know it is a real one because I know the kind of dollars it will take to build an industrial park in the city of Buffalo—are the infrastructure dollars. If we could combine the incentives we passed with the infrastructure dollars to enable cities to build industrial facilities, and the environments that are needed, and have some type of working capital arrangement or venture capital arrangement so people can go into business, where people can expand business when the markets will allow, we would have a viable total package. Without the other two, I don't think the tax incentives alone will do the job that has been professed and certainly in the old urban areas it probably won't provide the stimulus that is needed to totally revitalize and broaden that economic base and provide the type of diversity that we need.

Mr. Marriott?

Mr. MARRIOTT. Thank you, Mr. Chairman.

Mr. Mayor, welcome to Washington. Let me ask you this question. I have never been a mayor, so I don't understand all of your problems, but I talk to a lot of them and it seems like a lot of the mayors are looking for more and more Federal subsidies as a way to solve their problems, be it through CETA, revenue sharing or one thing and another.

How do you square that with the concept of the Reagan administration that the way to get everybody going is to get the budget balanced and reduce the Federal spending levels. That, in effect, will send the proper signal to the marketplace which will then have the effect of reducing inflation which will bring interest rates down, and low interest rates will help do more for the cities than anything else.

How do you square that concept with the idea of, "Look, keep pumping more Federal money in here because we need the subsidies to make things go?" It seems like we are at odds with two different principles and concepts. Could you give me your feeling about whether or not balancing the budget is the way to go, whether or not the solution to the cities is in low interest rates and tax credits versus revenue sharing and CETA funds and all the rest, and how you put this in perspective.

Mr. GRIFFIN. Mr. Congressman, if the present Reagan program is the solution, God help our country. When I became mayor—you talk about the CETA program—33 percent of our work force was CETA. We took that down to 16 percent of our work force. In September, September 30 there will be zero. We will be laying off 800 CETA employees. That came down from 1,600. We are going to struggle without these CETA employees. But I feel sorry for the CETA employee.

Thank God we kept enough money to pay their unemployment insurance. What happens after that? It is not a burden for the Federal Government but these people will be going back on welfare. That is going to be a burden for the county and the State. If you think that is a solution for getting our economy going I think it is the wrong solution. As I stated we are not asking for a handout. As I mentioned our revenue sharing was cut from $14 million to $5 million. There are no strings attached. Some of the people in Washington don't give credit to the mayors in this country. We know how to use the money. We are working with that money every day in the week. We cut our police department from 1,400 men to 1,000 men. We cut our street department the same. We cut our fire department the same. We are still struggling. When you are talking about not getting money from the Federal Government so you can balance your budget, we have to balance our budget every year. That is our constitution. That is our charter. I have to come in with a balanced budget.

When you take your dollars that should be coming to Buffalo and giving it to cities like Houston I don't think that is fair.

Mr. MARRIOTT. I don't argue, Mr. Mayor, with the allocation problems and I have no control over it. I am talking primarily about the philosophies. The facts of life are, as I see it, Government has gotton too big and out of hand. It has had a tremendous effect on pushing the interest rates up and the inflation rates up. How do you, at the same time, get those back down while you are still playing fair with the city and provide the assistance they need? I agree you should get as much of your tax dollars back to Buffalo as you can; but, isn't the solution to that in not going to the Federal Government to begin with? I am still confused as to your philosophy about solving inflation, unemployment, and getting the Government out of your affairs in that regard and, at the same time, having money available to take care of these other needs.

Mr. GRIFFIN. I don't mind the Government being in my affairs. I don't mind that a bit. In fact, our urban development action grants that we got from the Government under the Carter administration were one of the best things that happened. We rehabilitated buildings. We built a hotel. We were one of the first cities that had the grants that had it under construction and now it is built and it will bring $360,000 a year in taxes into the city of Buffalo and the county of Erie. It is employing 350 people and we are going to get that grant back in the city and use it for other things. I don't mind the Government being in my affairs as a mayor as long as I can work with them. That is the main thing and that is what we have been doing.

Mr. MARRIOTT. I understand that. What I am having difficulty with is this. There is a tradeoff some place; and, I am not sure I understand where it is in your city. Do you not believe that the Reagan economic package—I am not talking just for cities now, I am talking about the overall concept of tax cuts and tax cuts to businesses to stimulate capital formation—is it not in the long run the thing we have to get this country back to?

I am not saying it will work overnight, but what is wrong with that?

Mr. GRIFFIN. Would you expand your business and have to pay 21 percent for your money?

Mr. MARRIOTT. Absolutely not.

Mr. GRIFFIN. That is the answer to your question. That is why these block grant moneys that we are using in the city of Buffalo have helped over 80 firms. They have created employment in the private sector.

Mr. MARRIOTT. In the short run it has; but, in the long run, it may be fostering higher unemployment, higher inflation, higher interest rates and all the rest. What is the tradeoff?

Mr. GRIFFIN. Who are you to say that?

Mr. MARRIOTT. Who are you to say that is not the case?

Mr. GRIFFIN. Because I have facts that say we have created or retained 4,700 jobs in the private sector.

Mr. MARRIOTT. All I am saying is I think we have got to change the trends of the country to get back to where right now, if the private sector is doing this much, let's give them incentive to do this much; and, let's stimulate small business and this type of thing and reduce the impact of Government. In the long run, the city will be better off. That is my personal opinion.

Mr. GRIFFIN. What do you consider the long run?

Mr. MARRIOTT. I think between now and 1986, or 1987.

Mr. GRIFFIN. What are these people going to do between now and 1986 or 1987?

Mr. MARRIOTT. What people?

Mr. GRIFFIN. The people that got laid off the CETA program that we can't put in the private sector.

Mr. MARRIOTT. How do you know you can not put them in the private sector?

Mr. GRIFFIN. Because I am the mayor of the city and I see it every day.

Mr. MARRIOTT. I won't argue that. But I will tell you this. I look in the newspaper every single day in my city and I see want ads stacked four pages deep. I believe if a person wants to work in this country, they can find a job; and, we sure in hell don't need a CETA program if a guy wants to go to work. There are cases, I admit, in my own city where CETA has worked well; but, there is also a lot of abuse and a lot of taxpayers' money being wasted. My concern is, if you want to work, why do you have to rely on the Government? I think you have to rely on initiative and efforts and go out and get yourself a job; and, I think there are plenty of jobs out there.

Mr. GRIFFIN. That sounds like a great speech Mr. Congressman, but there are a lot of people out there that need work and the CETA program would work if it was run right—it was run right in my administration in Buffalo—we got excellent grades from the Department of Labor for our program. We are trying to do it again with our private industrial council. If you eliminate these funds and you say that the long run is 1986 or 1987, I hope we are both around to see what a great program Reagan had. I hope we are around to see that.

Mr. MARRIOTT. You have to admit that going with double digit inflation, interest rates 25 percent under the Carter administration program was not the solution, was it? That is why we are faced with cutting back, because we have dug ourselves a big deep hole. Now we have to climb out, and the cities are going to have to help us do it.

Mr. GRIFFIN. We have 21 percent now under the Reagan plan.

Mr. MARRIOTT. The Reagan plan has not gone into effect yet. We are still operating under the Carter plan, are we not?

Mr. GRIFFIN. No; we are not.

Mr. **Marriott**. I thought we were.

Mr. **Griffin**. He is not in there now.

Mr. **Marriott**. The fact is, the Reagan tax cuts don't take effect until next month, and we are working under the last Carter budget until the present fiscal year ends on September 30.

Mr. **Nowak**. Let us get back to the subject at hand. We are talking about trying to do something at the present time to put together a program that will work, whether we are talking about small, medium, or large size business in this country. One of the problems as I think was brought out by this last colloquy is certainly that the use of dollars and the priority of what few dollars are remaining is what we are really trying to target here in order to get the most value for the dollar. The question is whether or not the program that is sitting out there now that has been passed by the Congress is sufficient for the small business community in our country to take maximum advantage of. On the other hand, is there something more that could be done to make a business more viable and provide an opportunity for small business to recapture through capital formation the ability to expand in our cities? Are we giving them the correct amount of stimulus?

The problem with the CETA program as I see it, was that it went into some areas that were providing a substitution for public employment in our cities and in our counties and States but did not provide the full-time private sector job. I think what the mayor was trying to explain is he has used Federal dollars and transferred CETA dollars and CBDF dollars into a program where he is training certain skills in our private sector through the use of these dollars. It started to work very well where 150 or 200 new machinists would start off a program and now in the city of Buffalo Comtec is training computer operators for permanent jobs in the private sector as soon as the training session of 6 months or 1 year is over.

I hope we can stay on this kind of focus rather than the broad differences between the Reagan and the Carter programs.

Mr. **Marriott**. If the chairman would yield.

Mr. **Nowak**. We could go on all day to argue the philosophical differences of the two programs and how long it will take for stimulus but I think——

Mr. **Marriott**. Mr. Chairman, I want to say I am amazed at the mayor saying his solution in solving the problems of Buffalo are revenue sharing and CETA programs and that type of thing. I am trying to say I think that is not the solution to anybody's problem in the long run.

Mr. **Griffin**. You read me wrong. The CETA program is a good program if it is run right. We are doing that in Buffalo. We are using the people that are trained in the CETA program and putting them in private business. The chairman mentioned Comtec Research. We loaned $376,000 in our block grant money. They are training the CETA workers that got laid off for $17,000 jobs as computer programers. This is what I want to see happen. I said we could hobble along without the CETA workers in our city government and we have reduced it now to zero. Revenue sharing has been reduced from $14 million to $5 million. It is money we deserve. It is not a handout. If you can give money to Houston, Tex., and the rest of these cities who have budget surplus then I think you can give it to the city of Buffalo.

Mr. **Marriott**. I want to say in closing nobody has fought harder for revenue sharing than I have. But in the long run the way to get the economy going, and to get jobs, is to help stimulate private employment without the Government if possible. I think we can do it.

Mr. **Griffin**. I hope you can do it.

Mr. **Nowak**. Mayor, thank you very much for your testimony. We will be looking forward to trying to combine the most efficient use of those funds to bring together a package that will make a difference not only for the city of Buffalo but for all the cities in this country. We will be looking at what small business is able to do under the economy as it goes on for the next several months. We appreciate your testimony and want to thank you for taking the time and the effort to speak out on a very important subject.

Mr. **Griffin**. I want to thank you for your help to Buffalo.

PANEL CONSISTING OF WILLIAM DENNIS, JOSEPH BOWMAN, AND HAROLD CORNER

Mr. **Nowak**. Because of the similarity of the next witnesses to the National Federation of Independent Business I wonder if we could panel NFIB along with the National Tooling and Machining Association. We have Mr. William Dennis and Mr. Joseph Bowman representing the National Association of Independent Business and Mr. Harold Corner, for the National Tooling and Machining Association.

Gentlemen, we certainly want to welcome you.

TESTIMONY OF HAROLD CORNER, PRESIDENT, NATIONAL TOOLING AND MACHINING ASSOCIATION, ACCOMPANIED BY BRUCE HAHN, MANAGER, GOVERNMENT AFFAIRS

Mr. **Corner**. Thank you, Mr. Chairman and members of the subcommittee. My name is Harold Corner. I am president of Meadville Precision Tool & Mold, Inc., in Meadville, Pa., and I am president of the National Tooling and Machining Association. With me to my right is Bruce Hahn, manager of government affairs of the National Tooling and Machining Association. Our association represents approximately 12,500 companies and approximately 250,000 workers in the contract tooling and machining industry.

We appreciate your invitation to testify before this subcommittee on the subject of job creation. I will confine my remarks to the particular problems of the critical shortage of skilled labor in the United States.

The contract tooling and machining industry is the keystone of all manufacturing. For any assembly line in any industry to operate, from automotive to aerospace, it must be supplied with the tooling that this country—and only this industry—can produce. It is at the core of our industrial base. In addition, there is no weapon system that can be produced without the extremely high level of skills existing among the journeymen machinists stemming from our industry.

Approximately 20 percent of our members do work for the Department of Defense, mostly on parts at the subcontractor level.

Other members produce tooling for prime contractors. An acute problem for the defense subcontractor, as well as the private industry contractors in our industry, is an acute shortage of skilled labor, both for tooling and parts. The implications of this shortage are dire, both for defense procurement, as well as the overall U.S. industrial base.

In a 1980 report of the Defense Industrial Base Panel of the House Committee on Armed Services. Chairman Mel Price concluded that:

> In the event of a war, the U.S. defense industry would find it almost impossible to expand its weapons production suddenly and dramatically in the numbers necessary to sustain a prolonged conflict.

In the same report, the Defense Science Board task force concluded that a major contributor to the increasing lead time and cost currently affecting the defense subcommunity is a continuing shortage of skilled labor among small business subcontractors:

> It is clear that the shortages of machinists and other skilled laborers are contributing factors which adversely affect the ability of the subtier base to respond rapidly to significant increases in defense production demands.

If anything, this report may be understating the problem. An industry base survey conducted by NTMA in 1980 showed a shortage of 60,000 skilled workers right now with a demand expected to climb to 250,000 additional workers by 1985. Unless this critical skilled labor shortage is addressed, we will find that major weapons systems will face costly and time-consuming delays as they must wait in turn for the specialized, highly skilled services of one of our subcontractors. In a peacetime economy, they will be competing against private industry, which will be building new assembly lines as a result of the incentives for business investment provided in the President's tax package.

We believe the shortage of skilled labor is not related to wages paid to workers. A skilled journeyman earns between $25,000 and $40,000. Instead, we feel the shortage is caused by other economic factors which make the cost of training the highly skilled increasingly unaffordable to small companies:

The cost of training the highly skilled workers for this industry is extremely high. The cost includes a capital investment of between $40,000 and $60,000 per worker and 4 years of time while the worker completes the apprenticeship.

Most companies in small business industries are highly competitive. The relatively modest profits, small size, and lack of specialization do not afford the luxury of formal training programs. They are effective at 1-on-1 apprenticeship training in the old and traditional concept of skills training.

Where shortages of skilled labor already exist, there are usually serious backlogs and concurrent pressure on production. Small manufacturers are reluctant to take journeymen off their regular duties to train new employees because this slows production and lowers productivity.

The present skills shortage is living proof that existing programs designed to encourage training have failed to do the job.

Programs funded through the Department of Labor, such as CETA, have gradually become social uplift in orientation. They are designed to train the economically disadvantaged for jobs that may or may not exist, rather than designed to identify and train those qualified for the high paying, but equally demanding, available skilled jobs. The former may have sociological value, but the latter makes economic sense. A skilled worker in the tooling and machining industry, the high technology electronics industry, and others need certain mathematical skills and logical aptitudes, physical dexterity, patience, determination, perserverance, and imagination. They are perhaps the most highly skilled workers in America today. A journeyman moldmaker can render a complex blueprint, like the one displayed next to me, into a finished product, using a variety of skills and sophisticated equipment.

Our industry has run a CETA-funded preemployment program for 18 years. It has long been considered one of the best joint efforts between industry and Government. If it had been adequately funded and continued operating under the original Manpower Development and Training Act, it could have done a tremendous amount to alleviate the shortage that now exists. However, even if we were funded at high rates under the CETA criteria, the effectiveness and acceptance of this program would continue to deteriorate until the Government recognizes that basic aptitude, rather than socioeconomic background, is the single most important determinant of potential success for highly skilled jobs. Business must be permitted to recruit people with proper qualifications rather than be forced to recruit persons who are in many cases untrainable for highly skilled professions.

Tax credit programs, such as the targeted jobs tax credit, suffer from the same misdirection. In no way are they aimed at identifying and training the right kind of individuals for the available compatible jobs that exist today. Legislators have not faced a central truth. Not everyone from any population has the aptitude required to become a highly skilled machinist. Many of the economically disadvantaged are also often educationally disadvantaged. As a result, a smaller proportion of this population possess the aptitudes to be effective in this and other highly skilled professions. Any program which imposes inflexible restrictions on the population which can be trained or restrictions on techniques used to identify those who can be trained, will ultimately fail as a solution to the skills shortage in this country.

Vocational education programs have suffered from some of the same tendencies. In addition, there has been a lack of communication between the vocational community and the employer groups. Presently, there seems to be a trend toward better cooperation between the two groups and vocational education programs should be supported to encourage this desired change. However, this will take many, many years and solutions to the problem are needed now.

Mr. Nowak. Mr. Corner, we have a vote.

We will be in recess for about 10 minutes and we will then continue and pick up on your testimony.

[A short recess was taken.]

Mr. Nowak. The subcommittee will come to order.

We will continue Mr. Corner's testimony where he left off.

Mr. Corner. Thank you, Mr. Chairman.

An even broader problem is the failure of primary and secondary schools systems to provide the basic cornerstone in mathematics and English, which are the basic tools of all businesses, especially ours. The problem is getting worse, resulting in a smaller pool of qualified candidates each year.

Our industry has been viewing the problem for some time, seeking some efficient, logical, practical, and simple approach to the shortage of skilled labor in the United States. We conclude and recommend the following two courses to solve the skills shortage:

One: Joint industry/Government training programs should be continued and should be expanded, but the goal and operation should be returned to those of the original Manpower Development and Training Act of 1962.

The specific purpose of MDTA was to identify manpower shortages and fund programs which would train qualified people, as quickly as is reasonably possible in order that the Nation may meet the staffing requirements of the struggle for freedom.

This is a considerably different approach than is presently embodied under existing CETA programs. It may be that the original philosophy of MDTA could be applied to CETA by administrative action. We are sure the Secretary of Labor would appreciate suggestions from this subcommittee. It may be, however, that legislation would be necessary.

Two: A specialized skills training tax credit, available to those critical industries with a demonstrable shortage of highly skilled labor, should be enacted. The amount of the tax credit should be close to the true cost of training, which is quite high, in order to offset those costs and the loss of productivity which occurs during the training process.

The tax credit should be applied only to new apprentices and only industries or professions having a certifiable shortage should be eligible.

Two pieces of legislation have been offered which address this problem. The Job Creation Tax Act of 1981, introduced by Congressman Nowak and cosponsored by Congressman Marriott, would add a bonus credit to a base credit to encourage the hiring of employees in industries experiencing a shortage of skilled labor.

Under the bill, all employers would be allowed a credit, which could amount to as much as $3,000 during the first year of employment per employee. In addition to that amount, a bonus credit of as much as $2,400 would be added for each of 2 years if the employee is receiving skills training and in an industry with labor shortages.

A similar bonus credit applies to employers in distressed areas. Thus, a company could recover a significant portion of the cost of training a skilled worker. It would total $5,400 in the first year and $2,400 in the second year. The Nowak-Marriott bill, H.R. 3726, is one of the first bills to recognize the seriousness of the skilled labor shortage in this country and the economic differentials involved in training the highly skilled.

Subsequently, Congressman Don Bailey introduced the Critical Industry Reindustrialization Tax Act of 1981. This legislation provides a 50-percent credit of first year wages and a 30-percent credit or second year wages provided to the employer of any individual in a skills training program in an industry with a shortage of skilled labor. The additional advantage of this approach is that it automatically adjusts for inflation in wage rates.

We very much appreciate the opportunity to appear here today. Thank you.

Mr. Nowak. Thank you, very much, Mr. Corner.

Mr. Hahn, do you have anything to add?

Mr. Hahn. Not at this time.

Mr. Nowak. Thank you very much.

We will go to our other two witnesses. Proceed in any order you so desire.

We have Mr. William Dennis, director of research for NFIB and Joseph Bowman, associate labor specialist.

Gentlemen, welcome, and I will let you handle it from here.

TESTIMONY OF WILLIAM DENNIS, DIRECTOR OF RESEARCH, NATIONAL FEDERATION OF INDEPENDENT BUSINESS AND JOSEPH BOWMAN, ASSOCIATE LABOR SPECIALIST

Mr. Dennis. Thank you very much.

I would like to summarize our statement.

Mr. Nowak. Your statement will be admitted into the record in its totality.

Mr. Dennis. The second thing I would like to do before I forget it is to indicate to the subcommittee that a substantial and potentially very interesting study on this particular subject is now in progress, sponsored by the Small Business Administration and being conducted by the Urban Institute.

Basically, they want to look at this small business as a trainer, as a jobs trainer, what types of skills small business provides. They want to look at what extent the skills are given and things of that nature.

It really fits with this topic and I might encourage you to find out about it.

We would like to focus our remarks today on the labor problem, particularly the skilled labor problem. Our data principally come from our own sources which in many ways are very unique.

We find that over the past several years there are an average of 17 to 18 percent of small firms which at any one point in time have a skilled job opening.

Most of those skilled job openings have been vacant for over 6 months. Meanwhile at any point in time we basically find only about 6 percent of the small business population has a job opening for an unskilled position. Those positions are filled virtually instantaneously.

The industries which are most severely affected are the manufacturing industry, which averages about 23 percent at any one time and the construction industry, which is about 19 percent.

Regionally the West and the Southwest are those most affected by skilled shortages. The Northeast and the Midwestern Central States are those which seem to be impacted the least. The differential is about 5 to 7 percentage points.

To give you an idea as to how severe this is, when we have asked our people to provide the single most important problem over the past several years, 12 percent of manufacturers have indicated the quality of labor is their single most important problem.

Remember this period we have gone through. We have gone through a period with enormous interest rates; we have gone through a period with incredible inflation. Yet still we find over 1 in 10 say this is their single most important problem.

What are the kinds of general complaints? In other words, if this is an important problem, what kinds of complaints do small entrepreneurs commonly have about the pool of labor?

The most prevalent one is a lack of job skills. This is a common complaint of 2 of 5 of all small employers. But this is not the only one. Some of them are perhaps as interesting if not more so: 13 percent indicate that as a common complaint job applicants are functionally illiterate and cannot do elementary computations; 21 percent indicate that appearance, just knowing how to dress properly for work, is a common complaint.

I would like to direct some of my remarks specifically to the city, to the urban areas, since that is a particular topic of interest.

We have found that in a rank order of 25 potential small business problems in an urban area, the first five directly have to do with increased costs. But the sixth has directly to do with finding or locating qualified employees.

In other words, assuming that this inflationary spiral along with interest rates was under control, the inability to locate qualified employees—we are not just talking about skills although that is the most major one—the ability to locate qualified employees is an enormous across-the-board small business problem.

When we divided the neighborhoods in which the entrepreneurs are located, we found that whether you were located in an attractive neighborhood, an average neighborhood, or a rundown neighborhood, on all employee variables except one, there was no critical difference.

The one where there was an exception and the one where the rundown neighborhood found their problems to be most severe was again locating qualified employees. So, not only do you have a situation where this is an enormous problem anyway, but when you get into deteriorating neighborhoods this becomes even more critical. This is the primary labor differential within this entire standard metropolitan statistical area.

Finally, I would just like to make a few passing remarks that reflect on enterprise zones. In this "Small Business in American Cities" report that we will publish next month we asked operating entrepreneurs to reflect back on their early days in business and to tell us what their principal problems were.

For those starting a new business, in contrast to purchasing a business or inheriting a business or something like that, they had what we call the big four. They are not in any particular order, but first was learning how to to run a business, a management function. They had to learn how to run their own business.

Second, a low level of initial sales. They were having problems marketing.

Third, getting adequate financing. This is not an uncommon problem for beginning entrepreneurs.

Fourth, finding a good affordable location. At the bottom of the line with no more than 5-percent checking them as one of their two most important problems were taxes, advertising, city licensing permits, zone and regulations, and finding suppliers.

This is strongly suggestive that the idea of providing marginal rate reductions or marginal reductions in taxes really is not the kind of thing that is going to stimulate the entry of new businesses into depressed areas in our Nation's cities.

I would like to just conclude with one simple comment. We don't pretend to be experts in manpower training. However, it seems to us that when 1 out of 10 small employers as a base, complains that job applicants are functionally illiterate, we have something seriously wrong with the public education system and perhaps that is the place to start.

[National Federation of Independent Business' prepared statement with attachments follow:]

Prepared Statement of James D. "Mike" McKevitt, Director of Federal Legislation, National Federation of Independent Business, Submitted by William Dennis, Director of Research

The National Federation of Independent Business (NFIB), which has in excess of 500,000 small business members, is pleased to participate in this hearing regarding job creation and the revitalization of small business. The information we have to offer should help Committee members understand some problems small business employers have with the labor force available to them.

EMPLOYER DEMAND FOR SKILLED AND UNSKILLED LABOR

NFIB has surveyed its members on a variety of labor issues over the last several years. One question regularly asked is, "Do you have any job openings that you are not able to fill right now?" Employers are asked to simply designate "Yes" or "No". If their answer is "Yes," they are to specify whether the openings are for skilled or unskilled employees or both. Over the period July 1975 to July 1981, an average of 17 percent to 18 percent of the surveyed employers responded that they couldn't fill positions for skilled laborers.

Table 1 provides percentages of employers by industry type who reported difficulty in filling job openings for skilled workers. An average of 23 percent in the manufacturing industry responded that they couldn't fill positions for skilled workers. Nineteen percent of the employers in the construction industry reported that they couldn't fill positions for skilled workers. These two industries appear to be the most severely affected by skill shortages. This is significant because these industries are extremely important to our economic base. When they experience difficulty with their labor force, and a corresponding reduction in productivity, our entire economy feels the strain.

Employers do not experience nearly the shortages of unskilled labor that they do for skilled labor. Only about 6 percent of the employers surveyed during the period from July 1975 to July 1981 reported that they had job openings for unskilled labor. Although this figure is not particularly high, it is still surprising given the relatively high unemployment rate we have experienced over the past few years. One would expect that a high unemployment rate would indicate the existence of a large selection of laborers from which an employer could choose. Under such conditions, few employers should report shortages of unskilled laborers. In fact, we can see from Appendix I that to some extent, this theory is borne out. That table shows a tight inverse relationship between the unadjusted unemployment rate and the percentage of employers reporting job openings for unskilled workers. As the unemployment rate goes up, the percentage of employers goes down, and vice versa.

Table II shows percentages of employers in various regions of the country who reported having difficulty filling positions for skilled workers. The West South Central Region of the country, which includes Arkansas, Louisiana, Oklahoma, and Texas, has the most difficulty filling positions for skilled workers. Employers in the Pacific Region, which includes Alaska, California, Hawaii, Oregon, and Washington, and the Mountain Region, which includes Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, and Wyoming, also have a great deal of trouble finding skilled labor. On the other hand, employers in the East North Central Region, which includes Illinois, Indiana, Michigan, Ohio, and Wisconsin, and the Mid-Atlantic Region, comprised of New Jersey, New York, and Pennsylvania, seem to have the least amount of trouble finding skilled labor.

The important thing to notice about these regional figures is employers in those areas which are traditional industrial centers (New England, West North Central, East North Central and Mid-Atlantic) are experiencing the least trouble in locating and hiring skilled employees. These traditional industrial centers, however, have been losing population relative to the Mountain, Pacific, and West South Central regions. These are the areas where employers are experiencing the most difficulty in locating skilled workers. One reason for this could be that industry is simply moving to the South and West faster than skilled labor. As industries move into these regions, they experience labor shortages. These shortages will persist until areas which are experiencing industrial growth acquire the skilled workers to match that growth.

It is clear from NFIB studies that the major labor shortages experienced by employers are for skilled workers. If a Federal employment policy is to be effective, it must be reponsive to this need. It must provide a mechanism that predicts and supplies labor needs of employers. By putting emphasis on the needs of the employers, a Federal employment policy can best serve the needs of the workers.

QUALITY OF LABOR

NFIB has monitored employers' perceptions of the quality of labor for a number of years. In an ongoing NFIB survey, employers are asked, "What is the most important problem facing your business today?" Employers are asked to choose from a list of their most important problems. Included in the list of problems are "Taxes," "Inflation," "Inadequate Demand for Product," "Interest Rates/Financing," "Minimum Wage Laws," "Cost of Labor," "Government Regulations," "Competition from Large Business," "Quality of Labor," and "Shortages of Fuels, Materials or Goods." During the period of January 1974 to January 1981, an average of about 7 percent of those surveyed reponsed that "Quality of Labor" was their most important problem. The range of responses fluctuated between 3 percent and 10 percent.

The percentage of employers reporting the quality of labor as their most important problem varied considerably from industry to industry. As Table III indicates, a larger percentage of employers in the manufacturing industry and the construction industry perceive the quality of labor as their most important problem. On the other hand, employers in the retail and wholesale industries and in financial services and professional services seem to have the least problems with the quality of labor.

In a recent study of small retail business in urban areas, NFIB asked employers to rank each of the 25 business problems on a severity scale of 1 (Severe Problem) to 5 (Never a Problem). Table IV is a list of these problems ranked accordingly. Employers said that locating qualified employees was their sixth most important problem. Notice that this problem is the only one out of the top seven problems that does not involve a direct cost of some kind. This should illustrate the magnitude of the problem.

The same study also determined that by successfully dealing with the problem of locating qualified employees, other important problems with the labor force may be solved. For instance, Table IV indicates that "Cost of Labor" ranks fourth on the severity scale. If a Federal employment program can produce a higher quality of labor, i.e. reduce the locating of qualified labor problem, the cost of labor problem may be alleviated as well. Conversely, by reducing the cost of labor, employers may perceive less of a problem regarding the quality of labor.

Despite the relatively high rating of the "Locating Qualified Labor" problem, the study showed that urban employers did not necessarily feel that the answer was to improve jobs training programs. There is no data to provide an explanation for this anomaly. However, it seems fair to conclude that employers do not equate jobs training programs with improvement in the labor force.

This point is consistent with findings of the 1977 "NFIB Employment Report for Small Business." In that survey, employers were asked to choose from a list of their most common complaints about job applicants. Predictably, employers' greatest complaint was a lack of job skills among their applicants (see Table 5). However, a surprising number of employers complained that many of their applicants couldn't read, write, or make simple computations (13 percent). (Another significant number complained about the personal appearance of their applicants (21 percent).) These complaints are indications that there is a much more fundamental problem with the labor force than just a lack of job skills.

CONCLUSION

The problem of matching the right job with the right person has already received a great deal of attention. Economic studies of the subject are numerous and many of them have had a significant impact on Federal, State and local expenditures. In 1979, all of the Federal employment programs cost the Federal government over $3 billion. This money went into CETA as well as non-CETA programs, such as the employment service, vocational education, apprenticeship programs, jobs and training programs for disadvantaged target groups, the work incentive program, employment tax credit, and many others.

However, despite the abundance of Federal employment programs and the Federal revenues that have been generously outlayed for them, many potential workers are still without a job or a skill. In addition, many employers are dissatisfied with the general quality of labor available to them and have difficulty finding needed skilled workers.[1] Consequently, the unemployment rate hovers around 7 percent and industry efficiency is hampered by a poorly educated, badly trained labor force.

It seems clear that the conglomeration of Federal employment programs has been of little help to workers or employers. One study estimates that Federal expenditures in this area have focused on only about the 10.5 percent of the labor force that is structurally unemployed or engaged in entry level training.[2] This is a pitifully small number of people considering the resources and revenues already sunk into the numerous employment programs.

We are not experts in job training. However, it appears to us that any program to improve the quality of the labor force will depend to a great extent on the public school system. Employers want workers with a strong basic education and a sense of responsibility toward themselves and their work. The high incidence of illiterate or semi-literate applicants seen by employers is an indication that the public school system is not supplying workers with these qualities.

Until the public schools provide the desired level of education, we can't expect the work force to possess the most basic skills let alone the specialized, sophisticated skills in demand by employers. Once this is understood, it is easy to see that the major investment for a Federal employment policy should not be on expensive skill specific training programs, but on our established, but faltering, public school system.

TABLE I.—*Average percent of employers who can't fill available positions for skilled laborers (January 1974 to January 1981)*

Industry:	Percent
Construction	19
Manufacturing	23
Wholesale	17
Retail	15
Agriculture	15
Financial service	12
Non-Professional services	18
Professional services	14

TABLE II.—*Average percent of employers in various regions reporting difficulty in filling positions for skilled labor (January 1974 to January 1981)*

Region:	Percent
West South Central	26
Pacific	20
Mountain	19
South Atlantic	19
East South Central	18
New England	17
West North Central	16
East North Central	15
Mid-Atlantic	5

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[1] National Alliance of Business, *Options for the Future of Federal Employment and Training Prospects* (Policy Paper), August 28, 1981. (unpublished)

[2] Ibid.

TABLE III.—*Average percent of employers designating "quality of labor" as their most important problem (January 1974 to January 1981)*

Industry:	*Percent*
Manufacturing	12
Construction	10
Non-Professional services	8
Agriculture	7
Retail	5
Wholesale	5
Professional services	5
Financial service	2

Source: "NFIB Quarterly Economic Report for Small Business."

TABLE IV.—*Rank order urban small business problems (January 1981)*

Problem:	*Rank order of mean score*
Interest rates	1
Cost of insurance	2
Cost of energy, utility bills, etc.	3
Cost of labor	4
Local tax rates	5
Locating qualified employees	6
Cost of supplies/inventory	7
Cash flow	8
Low profits	9
Crime rate	10
Competition from large firms	11
Workers compensation	12
Insufficient sales	13
Controlling inventory	14
Ability to cost-effective advertise	15
Employee turnover	16
Obtaining needed loans	17
Cost of rent	18
Lose skilled employees to large firms	19
Local inspections and inspectors	20
Ease in getting licenses/permits	21
Employee relations and/or unions	22
Unfavorable business location	23
Access to highways, roads, parking, public transit	24
Garbage collection	25

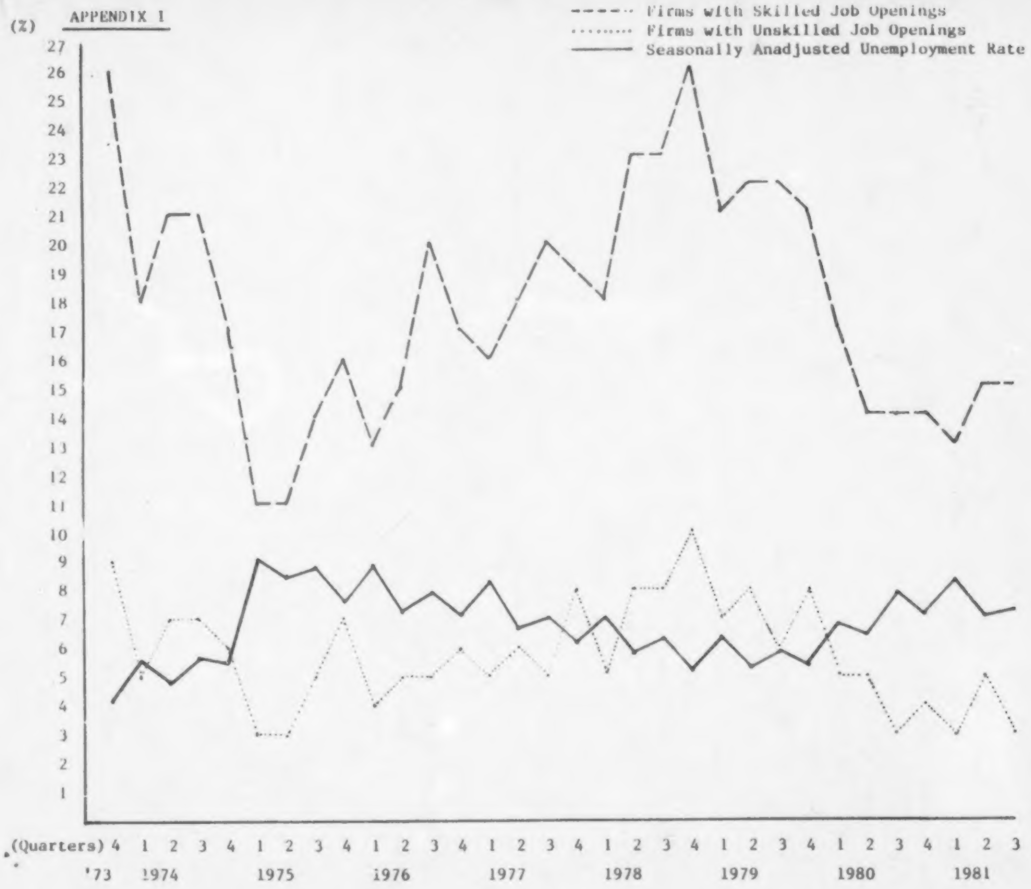
TABLE V.—DISTRIBUTION OF EMPLOYER COMPLAINTS ABOUT APPLICANTS

	Complaints about applicants					
	Won't stay long	No job skills	Can't read	Inflated wage expected	Appearance	No complaints
Percent of employers with complaints[1]	38%	39%	13%	34%	21%	19%
Average number of applicants per acceptable applicant	4	5	5	5	6	5

[1] Adds to more than 100% since respondents could give more than one answer.

Source: "NFIB Employment Report for Small Business."

APPENDIX 1


(%)
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1
- - - - Firms with Skilled Job Openings
.... Firms with Unskilled Job Openings
——— Seasonally Anadjusted Unemployment Rate
(Quarters) 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4 1 2 3
'73
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1975
1976
1977
1978
1979
1980
1981

Mr. **Nowak**. Thank you very much.

Would you have any comment, Mr. Bowman?

Mr. **Bowman**. No, sir.

Mr. **Nowak**. Would you repeat for me the four? I am looking at your testimony and I don't see that in here.

Mr. **Dennis**. This is going to be published: For starting business it is learning how to run a business, or management; a low level of initial sales; getting adequate financing, and finding a good affordable location.

Mr. **Nowak**. The four last?

Mr. **Dennis**. The four at the bottom were taxes, advertising, city licensing, et cetera, and finding suppliers. The one more or less in the middle which I did not mention was getting qualified employees. These vary somewhat by the method of business entry. It varies a little if an individual inherits a business or purchases it from a relative or if he is brought in to the ownership structure it varies again.

But since the zone concept, as I understand it, principally focuses around starts, that is why I chose to provide that particular information.

Mr. **Nowak**. I think it was very interesting. We had received other testimony that substantiates, and your survey will substantiate our thinking. Tax cuts are the immediate relief or the incentives providing internal cash flow that we need to help businesses expand for the initial startups and the initial business. The idea that in order for them to have that opportunity to work you are talking about calls for some type of working capital, loan capital, some access to capital, whether it be through a private venture corporation or whatever, at affordable rates that can sustain that slow period of sales which you refer to.

Location is the other very important element. Of course, the mayor here today mentioned location. I am not trying to confine the location to an area that is too restricted because you are not going to have the ability, especially in cities, to put an industrial park contiguous to or within a residential area that you hope to draw and train employees from.

This will be out next month?

Mr. **Dennis**. Yes, sir. What we have done in this particular study is to take a look at a number of aspects of urban businesses. First, we wanted to look at what they perceive to be their problems.

Second, we wanted to look at new business starts.

Third, we wanted to look at the mobility of businesses, both in terms of changing sites or changing locations as well as adding them.

Then, finally, we wanted to take a look at their perception of their city, their perception of their public officials at the local level and their perception of the services that they were receiving.

One thing I think you will find very gratifying and certainly very supportive of the idea that small business is an intrinsic portion of the economic development effort of any city, is that perception of small business toward their city is a highly optimistic one.

One of the most remarkable findings, at least in my judgment, was that even in the various distressed cities, as classified by

UDAG classes 6 and 7, a majority, a large majority saw their city over the next 20 years as growing at an average or above average rate.

Similarly, they saw their city officials as basically helpful to small firms. So there is really an enormous reservoir of support, even in the most distressed cities and obviously in the well-off cities.

Mr. NOWAK. The tax incentives which we have passed already, I think are going to have a long delayed effect. Others are of the opinion all of the incentives will start to affect the economy right away.

I see a much longer state of impact, especially to so-called start-up businesses. I really don't believe businesses are going to move until the markets are changing and they can see a reasonable chance of marketing a specific product for a specific need.

Then, of course, incentives will mean something. But from what your survey has shown, I wonder if you could generalize and tell us what you feel; is there enough encouragement in the present so-called tax incentives for small business or to start a small business in an urban area?

Mr. DENNIS. I think you have to look at where the potential entrepreneurs obtain their financing originally. We have found that there are two primary sources of financing a new small business.

If you are going to start one rather than purchase one or whatever, there is a 60-percent chance that your single most important source of capital is going to be your own pocketbook. There is a 20-percent chance that your single most important source will be a financial institution of some kind. Now, to the extent that the tax bill returns income to your pocket, as you say you are a working individual, working for someone else who wants to go off on your own, this will give you additional savings.

On the other hand, until such time as interest rates are reduced, the ability to borrow, whether it is on your house or on something else, is severely curtailed.

Mr. NOWAK. There was an analysis of development and they looked at the opportunities to invest money, even if we relate that to the 60 percent of the people that you said would use their own funds. And the critical factor was, of course, if those dollars could be invested at rates in the money market funds of today about 1.4 and higher, whether or not that would discourage a lot of people from striking out on their own, because of the possibility of a substantial return of that kind without any so-called work effort and without risk taking.

Mr. DENNIS. I am not sure that it would retard somebody from entering. I think it is retarding a lot of people from expanding. When we look at the initial motivation for entering a business, there are some who enter strictly for the idea that they are going to do better financially by entering their own business than by working for someone.

But generally it is much more complicated than that and has to do with independence, doing the kind of work they want to do, things of that nature which are not directly and monetarily related. However, we have certainly seen several examples among our membership where people have taken their investment capital that they would normally use to put in a new machine or to expand their plant or to put on a couple of new salesmen or whatever they were going to do, and invest it in money markets and other things where potential return on investment is greater, yes, sir.

Mr. **Nowak**. Mr. Corner, if I may, one of the problems of course that was mentioned here was the skilled labor and how that either helps a business to expand or perhaps even retards a business from starting if skilled labor simply is not available.

Under title VIII of the CETA program they have formed the private industrial concepts and that has been used to my knowledge in several different industries around the Buffalo area.

What happened there is that the corporate president retired and he was asked to take over the whole private industrial council presidency and he did so. Within a matter of 6 or 8 months there were about three or four different types of skills that were being taught although I don't think they are on the level of a machine tool operator.

Are you aware of any of this private industrial council work that has been successful in your industry in the country?

Is that a possibility for further expansion?

Mr. **Corner**. I am not aware of any specifically, Mr. Chairman. I think one of the problems in our industry, as I stated, is the problem of having the freedom to select a qualified candidate. That is the basic problem in our industry.

All of those shackles that have been hung on our industry, restrictive testing and all of those which would point out one's capability or competency, compared with the significant investment that one must have, a small businessman must have approximately $5,000 in capital equipment before he can even start an apprentice training in addition to spending $40,000 or $50,000 per employee to train a qualified skilled person coupled with the fact that the big businesses in this country today have stopped their training programs.

They have stopped and reduced their training programs since the end of World War II. We have evidence of, in our association and our industry, where major aircraft manufacturers on the west coast have come into small business parking lots and put placards on employees' cars offering bonuses to transfer from their small member firms to a large corporation.

Just this last week we had evidence of another major firm, not too far from Buffalo, your city, where a major corporation is now employing the recruitment practices of every employee in his plant, offering them a $500 cash bonus if they will recruit a journeyman toolmaker or machinist from a job shop to small business of those communities, simply because they have not done their fair share of training.

The small businesses in this country are basically providing the skilled mechanics to big business, much the same as the colleges are providing football players to pro football with no compensation. The dilemma of the small business coupled with the minority or the small profits and the cost of training, there needs to be tax credits in order to enable that small business person to make that investment in a young person to offer him the skills training that is required to be efficient in our industry.

Mr. **Nowak**. Once an investment is made in training and a larger corporation comes with the financial capability of offering more dollars and more fringe benefits and the other things that go along with it, this problem has to be particularly distressing to somebody who at the same time has an opportunity to expand and cannot because of the loss of skilled laborers.

How broad a problem is this?

Mr. **Corner**. It is a universal problem. Even in our area, Buffalo, Erie, Pittsburgh, we have a lot of joblessness. We have a lot of unemployed people. Yet in every inch of those papers are employment ads for skilled machinists, moldmakers, designers, engineers and those jobs continue to go unfilled even in the areas of high unemployment.

When you go out through the Midwest and the Southwest and the Sun Belt the problem is much, much more prevalent.

Mr. **Dennis**. Mr. Chairman, it is just not in that industry either. Go into some of your high technology industries. In the Silicon Valley in California, for example, they are advertising over radio and television for employment of skilled employees.

Apparently, in the Dallas area there is almost a war going on between competing firms in some of the high technology areas to get employees. In Louisiana, having to do with the oil industry, they can't train people fast enough for some of those very skilled jobs. While these are not necessarily in the depressed Northeast, nonetheless my point simply is that this is not the only industry. The tool and die industry is not the only industry.

It is characterstic of many industries.

Mr. **Nowak**. Setting aside for the moment the problem of people making an investment and then losing an employee after making a total investment, I guess the point comes down to how we structure any kind of relief if we are talking about lessening the types of restrictions on the initial people that are going to be trained and how you compensate a small company.

Even if you do compensate a small company for the period of time that that person is trained, where and how can that small employer, after he has gone through the heartache of a training period, at probably a substantial cost of money, how does he retain that skilled person after he receives his master?

Mr. **Hahn**. We would hope the tax credit approach would be substantial enough incentive, No. 1, to encourage a greater amount of training among the small businesses and at the same time encourage some of the larger businesses that have not been training to undertake their own training programs.

I might add, this is subjective information, investing, this problem, I talked to programs 20 different associations representing different industries to try to find if there was any correlation between this, the shortage of skilled labor.

This is subjective. The correlation seems to be this: The higher the level of skill and the smaller the typical size of the business in that industry, the greater the problem.

There seems to be a correlation with high level of skills in smaller businesses. That is where you get your worst problems.

Another one, as this gentleman mentioned, that has a problem is the high technology electronic industry, smaller high technical-type firms.

Mr. **Nowak**. It would seem even if we looked at a program to target this into, to solve the problem of the smaller business, I guess what you are saying is once a person is trained, even if an adequate tax credit would be set up, the tax structure of the large corporation is different from the small. However, even if the small business could take advantage of it and has the growth of profit from which to work, you are going to have a situation where you are going to lose that employee in any event because of higher gross salaries that could be paid by a larger corporation that wants that skill.

Mr. **Dennis**. But isn't the ultimate solution creating a sufficient pool of skill? So even while that may proceed for a certain period of time, if we can begin to catch up on the skilled shortage and have a supply and demand situation where they are approximately equivalent, then we will be able to satisfy both the needs of small and larger firms.

Mr. **Nowak**. What you are suggesting is trying to expand the tax credit in this regard to provide for a greater labor pool of skilled or semiskilled people or literate people. I am talking right from the bottom up, and how we can put that into effect with tax credits. This would enable at least that training to be put in place and then, of course, you are going to create the kind of labor pool that everybody could expand to by using the tax code rather than an overt so-called Government program.

In the CETA program, they are training some 200 computer operators, computer analysts and they were taken, I think, off the competitive exams that were given and backgrounds screened very minutely by the firm that has put this program in place.

What the firm and the CETA program director did was lease the space right from the company and put the program into effect right at the company with the so-called on-the-job training.

Also, in combination with that, they did receive tax credit from the New York State Division of Labor, so at that time for every person employed and trained, they will have a permanent job at the end of the period and also have the advantage of the tax credit. But this is going to be very interesting.

We expect problems as we get into more sophistication in not only your industries, the tooling industries, but in the other new technologies that are growing. How are we going to transfer the 45 million people that are going to be affected by new technologies, that are going to have to retrain and acquire new skills if we are going to survive? Certainly, it seems more evident than ever that we have to start a program like this and get the right combination of incentives so that people will participate and that employers can provide this type of training.

We may have further questions for each of you. I will hold the record open until we are able to review all the files. Certainly, we want a copy of that report.

Mr. Corner, again, thank you very much for spending the time with us and also, of course, the National Federation of Independent Business.

We will take a recess for about 10 minutes and I will come right back.

Thank you very much.

PANEL CONSISTING OF LAWRENCE REVZAN, SEYMOUR JONES, AND WILLIAM J. BARROW

Mr. **Nowak**. We would now have the firm of Coopers & Lybrand represented by Lawrence Revzan who is director of economic development consulting for the firm. He has been active in urban economic development for over a decade and is formerly chief of planning at the Economic Development Administration. We welcome you here. I understand that we also will panel the American Association of MESBICS represented by Mr. William Barrow. Mr. Barrow is director of business investments and has an M.B.A. from Wharton and a J.D. from Georgetown.

Gentlemen, welcome. Mr. Revzan if you would like to start I will admit your total statement into the record and let you proceed as you so desire.

TESTIMONY OF LAWRENCE REVZAN, DIRECTOR, ECONOMIC STUDIES, COOPERS & LYBRAND, ACCOMPANIED BY SEYMOUR JONES, PARTNER

Mr. **Revzan**. With me today is Seymour Jones, a partner in our emerging business group. Mr. Jones has been providing business planning and financial advice to newly acquired and emerging businesses for over 20 years. He served on several boards and committees and is coauthor of the soon to be published Entrepreneur's Financial Handbook.

Mr. **Nowak**. This is Mr. Jones from the New York City office?

Mr. **Jones**. Yes.

Mr. **Revzan**. In addition to my testimony this morning I would like to present for the record a paper I have authored, entitled, "Enterprise Zones in the Economic Recovery Tax Act of 1981. Will Zones Have a Comparative Advantage?" It is to be published in Industrial Development magazine this fall.

Mr. **Nowak**. Without objection that will be included in the record.

[The paper referred to above follows:]

ENTERPRISE ZONES AND THE ECONOMIC RECOVERY TAX ACT OF 1981: WILL ZONES HAVE A COMPARATIVE ADVANTAGE?

INTRODUCTION

Now that major Federal tax reform legislation has been signed into law (PL 97-34, The Economic Recovery Tax Act of 1981), legislative proposals to establish "Enterprise Zones" (EZs) in selected areas of the country must be reassessed.[1] The primary reason for reassessing EZ proposals is that PL 97-34 provides the same types of tax incentives offered in both the original Kemp-Garcia Bill ("Urban Jobs and Enterprise Zone Act of 1980") and a variety of EZ Bills introduced in Congress in 1981[2] very closely, without imposing any geographic restrictions on investment.

Thus, not withstanding one's position regarding the role of EZs in urban (and rural) development policy, an important policy issue is the degree to which EZs can be effective in attracting private capital given the passage of PL 97-34. In other words, how could EZs be expected to achieve a comparative cost advantage to businesses given that the same types but not necessarily magnitudes of tax incentives are provided regardless of where they locate?

SPECIFIC TAX INCENTIVES PROVIDED IN PL 97-34

Several provisions of the new law that can have an immediate and dramatic impact upon business and personal financial plans and investment strategies are as follows:

- Reduction of maximum tax rate on long-term capital gains from 28% to 20%
- Increase in amount of investment credit and the complete new system of accelerated depreciation methods and lives (referred to as ACRS, the Accelerated Cost Recovery System)
- Increase in rehabilitation credit amounts for property 30 years and older (including historic structures); the current 10% credit for 20- to 30-year structures will lapse
- New research and development (R&D) credit of 25% applied to wages, supplies and payments to another person for the right to use personal property in conducting R&D
- For small businesses, such changes as increasing the investment tax credit limitation for used property to $125,000 in 1981 and $150,000 in 1984; increasing the shareholder limit for Subchapter S corporations from 15 to 25; increasing annual limitation of deduction for qualifying personal property
- Extension of Targeted Jobs Tax Credit (TJTC) program to January 1, 1983, and tightening of certification procedures.

The above changes are in addition to the uniform reductions across all individual tax rate brackets, the reduction in the top rate of taxation applicable to dividends and interest, and major changes in the taxation of estates.

There are also several provisions of PL 97-34 that pertain specifically to the real estate (development) industry:

- A 15-year depreciation period will be available for most depreciable real property utilizing 175% declining balance depreciation (unless the straight-line method is elected)

- When "substantial improvements" are made to certain existing buildings, such improvements will be considered separate properties and therefore entitled to the benefits offered by ACRS

- As noted above, increase in rehabilitation credits (for "substantially rehabilitated" buildings retaining 75% of their existing walls) as follows:

  - .. 15% for commercial structures at least 30 years old

  - .. 20% for commercial structures at least 40 years old

  - .. 25% for qualified historic structures (5-year rapid amortization rule repealed)

  If credit is claimed, rehabilitation expenses must be recovered on a straight-line basis; the basis of rehabilitated property (other than historic) is reduced by the amount of credits allowed. The old 10% credit is still available for buildings 20-30 years old on which physical work begins before the end of 1981, but not thereafter

- For low-income housing, 200% declining balance depreciation can be taken with an optimal change to straight-line. The amount of rehabilitation expenditures qualifying for favorable 5-year amortization has been increased from $20,000 to $40,000 in certain situations. Also, rules requiring capitalization of construction period interest and taxes have been eliminated for low-income housing.

In general, the Accelerated Cost Recovery System (ACRS) has been established to provide for more rapid depreciation of capital assets over 3-, 5-, and 10-, and 15-year periods, and liberalization of the investment tax credit (ITC) as follows:

- cars, light-duty trucks, research experimentation equipment in 3-year class

- most personal property in 5-year class

- theme park structures, mobile homes, railroad tank cars in 10-year class
- All other depreciable real property in 15-year class
- ITC of 6% for 3-year qualified property and 10% for all other qualified property, with carryover period extending to 15 years; increase in used property limitation.

The above types of provisions are all expected to impact capital investment decisions; what is not known at present is their impact on the overall level of investment, its sectoral mix, and the relative advantage of distressed areas (including inner cities) and locations for investments, particularly those involving new and/or rehabilitated real property.

HIGHLIGHTS OF PROPOSED ENTERPRISE ZONE LEGISLATION

The chart on the following two pages summarizes the key incentives offered in the four EZ Bills presently being considered (described in footnote 2 at end of paper). As can be observed from the chart, these bills differ widely both in terms of their areas of emphasis and in terms of what they are proposing specifically in each area emphasized. For example, Kemp-Garcia is relying heavily on reductions in such areas as business income tax rates and capital gains tax rates, but does not address changes in depreciation schedules. Rangel places heaviest emphasis on added use of Targeted Jobs Tax Credits. Nowak's greatest stress, on the other hand, is on increasing depreciation allowances for small businesses and on making ITCs refundable (another incentive to small businesses) up to

SUMMARY OF FINANCIAL INCENTIVES

PROPOSED ENTERPRISE ZONE LEGISLATION

	Kemp-Garcia HR 3824	Rangel HR 2950	Nowak HR 2965	Heinz-Riegle S 1240
A. Capital Formation				
1. Accelerated Depreciation	No Provision	No Provision	Increase first year additional depreciation allowance from $10,000 to $40,000 for small businesses (from $20,000 to $80,000 if joint return used)	Straight-line depreciation of first $500,000 of annual physical investment over 3 years. Above $500,000, buildings depreciated over 10 years and equipment over 3 years
2. Investment Credits	15% for low-income rental housing only	(a) 15% for new, non-residential structured (b) Increase rehabilitation tax credit to 20% for non-residential structures	(a) 5% for new, non-residential structures and used property with $400,000 ceiling. (b) Increase rehabilitation tax credit to 25% for non-residential structures (c) ITC refundable up to $100,000	10% on all zone investment in property
3. Capital Gains Tax	No capital gains tax for qualified investments in zones (must increase employment by 10%)	No Provision	No Provision	(a) Reduce maximum tax rate to 10% for corporations (b) Increase exclusion to 90% for non-corporate entities
B. Employment Generation				
1. Employer Income Tax Credit	5% refundable credit for wages paid CETA-eligible employees in zones (with add-back provision)	No Provision	No Provision	No Provision
2. Employer Use of Targeted Jobs Tax Credit (TJTC)	No Provision	(a) 50% of first $10,000 in wages credited first year; 25% second year; 10% third year for all targeted workers. (b) Additional 15% each year for targeted workers within zones. (c) 15% credit on first $10,000 for all workers hired within zones after 12/21/81.	(a) 60% of first $6,000 in wages paid area resident; 35% second year	12% of first $15,000 in wages to area residents per year (not restricted to TJTC-eligible workers)

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	Kemp-Garcia HR 3824	Rangel HR 2950	Nowak HR 2965	Heinz-Riegle S 1240
3. Employee Income Tax Credit	5% refundable credit up to $1,500 for employees in eligible business who work at least 50% in zones	No Provision	No Provision	No Provision
C. Business Income Tax Reduction	50% of business income from zone operations tax exempt (decline over time)	No Provision	No Provision	No Provision
D. Tax Credits to Investors	50% of interest earned on loans to zone businesses tax exempt (declines over time)	10% tax credit on interest earned from loans to zone businesses ($100,000 limit for individuals, $300,000 for partnerships and lending institutions)	No Provision	No Provision
E. Miscellaneous				
1. Cash Accounting for Small Businesses	Yes (gross receipts not to exceed $2 million per year)	No Provision	No Provision	Yes, without restriction within zone
2. Net Operating loss carry-foward	Extends to 20 years	No Provision	No Provision	No Provision
3. Subchapter S Corporation	No Provision	No Provision	No Provision	Increases maximum number of shareholders from 15 to 100
4. Business Contribution to ESOP	No Provision	No Provision	Deduction allowed for Employer Contribution to ESOP	No Provision

$100,000. Finally, Heinz-Riegle has a fairly well balanced program whose incentives address both capital formation and employment generation.

Two areas stand out when analyzing the proposed EZ Bills in light of the passage of PL 97-34:

(1) To be successful, EZ Bills must provide incentives that will ultimately lead to employment generation in distressed areas and, at the same time, an increase in the overall tax base of the local jurisdictions within which the zones are located

(2) Given the provisions of PL 97-34, EZ Bills must stress incentives significant enough to give zones a comparative cost advantage to prospective businesses/private investors over alternative sites; this can be in the form of incentives not offered in PL 97-34 and/or through a significantly greater incentive than that provided in PL 97-34.

For example, given the significant reform in the depreciation system (ACRS) and expansion of ITCs for rehabilitation and historic structures provided in PL 97-34, it would be difficult to create an incentive that would give a significant advantage to enterprise zones (with the possible exception of a refundable ITC for small businesses) that would be passed by Congress. This would also hold true in the areas of business income tax reductions and reductions in capital gains tax rates.

This leaves two areas of incentives not addressed to a great degree by PL 97-34: (1) Incentives to investors (generally targeted to small businesses) and (2) Wage credits to stimulate employment directly.

The types of incentives to investors in small businesses that have been proposed include:[3]

- Investment in original issue stock (incentive stock): 10 percent income tax credit up to a maximum of $1,000 per person ($2,000 for a joint return) held 12 months or longer.

- Small business participating debenture: treatment of payments received constituting distribution of a share of earnings of the issuer as a long-term capital gain to the holder and deductible as an interest expense to the issuer (business).

- Nonrecognition of gain of certain proceeds from sale of incentive stock: capital gains not recognized if incentive stock held at least 12 months and small business stock purchased with proceeds within 18 months of the sale (capital gains "rollover").

- Increase in number of Subchapter S Corporation Shareholders: increases limit of shareholders in subchapter S small business corporations from 15 to 100 (PL 97-34 increased the number only to 25). The underlying premise of subchapter S is to permit small, closely held corporations (essentially partnerships) the benefits of limited liability and the pass through of profits (losses) directly to shareholders without paying corporate income tax.

Each of the four EZ Bills offers some type of investor incentive (refer to chart), but the potential of these types of incentives has not been analyzed in a systematic fashion.

While PL 97-34 authorizes the TJTC through 1982, only EZ legislation has addressed the use of wage credits to stimulate additional employment (as well as capital investment) in designated areas. Kemp-Garcia has focused on credits to both employers and employees (effectively raising the after tax wage they can earn). The original Bill focused on credits against social security payments, while the new Bill would use refundable tax credits not to exceed 5% of qualified wages with a $1,500 per year maximum. Both Rangel and Nowak have focused on increased credits and simplified eligibilty rules under the Targeted Jobs Tax Credits (TJTC) program.[4]

In conjunction with proposed wage subsidies, Susan Jacobs and Michael Wasylenko[5] have analyzed how a wage subsidy program would work within the context of the Kemp-Garcia Bill. One of the areas they stress is the difficulty of achieving simultaneously an investment revitalization goal (which stimulates demand for capital and higher-skilled workers) and an employment goal (aimed at low-skilled workers residing in narrowly defined geographic areas). This dilemma may impair the potential effectiveness of wage subsidies in EZ legislation.

FACTORS AFFECTING BUSINESS SITE LOCATION

In a recent paper prepared by the author,[6] several studies on location decisions by manufacturers and other types of business were reviewed. In light of the stress on tax incentives in EZ proposals, and the need to coordinate those proposals with provisions of the Economic Recovery Tax Act of 1981, it is important to cover the highlights of those studies.

Most analyses have concluded that location and investment decisions are based on a comparative cost analysis (e.g., labor, capital, land, transportation), with various types of incentives perhaps serving as a tie-breaker in choice of a specific site once a general region is selected. For example, a comprehensive study conducted by the Federal Economic Development Administration[7] (EDA) in the late 1960's and early 1970's asked several questions about characteristics companies in selected manufacturing sectors would weight most heavily in making expansion decisions. In one sector, job stampings (SIC 34612, 38 respondents), the following community factors were rated as "critical" by respondents: fire protection (45%), availability of contract trucking and police protection (32% each), availability of unskilled (24%) and trained (16%) workers. Only 5 percent of respondents rated tax exemptions as critical, with 82% rating these incentives as "significant-to-average" in importance. Such plant site features as highway access (37% of respondents), natural gas service (29%) and solid waste disposal (26%) were the most significant. Similar results were recorded in the electronics sector (a fast growth industry), showing tax incentives again playing a relatively small role in business location decisions.

A more recent study conducted by the Industrial Development Research Council (1978)[8] surveyed its members (facility planners for manufacturers and, to a lesser extent, distribution, wholesale and commercial operations) to rate financial incentives. Representatives of selected businesses ranked the following incentives offered in order of importance:

- property tax exemption/abatement and/or capital improvements
- state right-to-work law
- tax exemption on inventories
- corporate income tax exemption

- industrial bond financing
- tax exemption/moratorium on equipment and machinery
- accelerated depreciation
- sales/use tax exemption on new equipment
- state-supported training
- tax exemption on raw materials
- inventory tax exemption on goods in transit

Research Associates of the IDRC were also queried and rated revenue bond financing and state-supported employee training as the most important incentives. Tax abatement/capital improvements were ranked fifth, and corporate income tax exemption was ranked ninth. The survey included only questions about financial incentives and excluded questions about costs of labor, proximity to markets, access to transportation of different modes, and so forth. Clearly, there are differences in opinion expressed by the two groups, the research associate sample generally representing government officials who are offering the incentives.

A second IDRC report[9] analyzed approximately 80 actual facility location decisions on a case study basis. This study indicates that more and more industries are selecting predeveloped sites in industrial parks for their plant locations. It also concluded that industries are seeking rural locations (manufacturers surveyed ranged from 12,000 square feet to 780,000 square feet), with limited central city activity among those sampled.

A recent study by the Joint Economic Committee[10] surveyed representatives of a large sample of central city businesses who indicated that financial incentives were not a major factor in their expansion/location decision-making process. Again, availability and price of factors of production were considered to be the most important in affecting choice of locations as well as such "quality of life factors" as city government attitude toward business, crime level, quality of city's schools, and cultural attractions. Among financial incentives listed, availability of investment tax credit (ITC), depreciation, and short-term financing were considered more important than (reduced) corporate tax rates and property tax rates by responding firms in almost all cities included in the survey. Moreover, the JEC study found that small businesses were the least likely to expand their operations in central cities; medium-sized firms (with 25-499 employees) were the most likely to expand operations. Finally, the need for reduced Federal paperwork and regulations "... was the single most widely expressed sentiment and was universally stated by all types and sizes of firms in all cities (among open-ended responses)."[11]

In the January 1981 issue of Commentary Magazine, this question was addressed again by Roger Schmenner with respect to large firms.[12] One of the questions addressed to corporations (all manufacturers) was identification of a list of "musts" for regional and state factors. The list and percentage of respondents identifying the factor included: favorable labor climate (76%), proximity to market (55%), attractive place for engineers and managers to live (35%), proximity to supplies and resources

(31%), low labor rates (30%), proximity to existing facilities of division/company (25%), ease in obtaining environmental permits (17%). The study found also that physical assistance from government was used by about 60% of plants newly opening (20% in the case of relocations), while financial incentives were used in 30% and 40% of the cases, respectively. The author concluded once again that "... taxes do not appear important to location decisions..."[13] and recommended, among other things, that tax and other financial incentives should not be utilized widely because their benefits are "... probably not worth the costs."[14] The author recommended that states and localities concentrate on helping with the physical process of site selection, plant construction, and start-up (e.g., provide site information, assist in securing permits, assist with infrastructure and labor training).

CONCLUSIONS AND POLICY RECOMMENDATIONS

1. Kemp-Garcia and Other Enterprise Zone Bills Must Be Assessed Within the Context of The Economic Recovery Tax Act of 1981.

Based on the comparison and analysis of specific tax incentives, it is clear that EZ Bills at present address only a limited series of areas (most notably wage subsidies) not covered to some degree in PL 97-34. In addition, S360 (proposed small business Legislation) offers a variety of incentives to investors not offered in EZ legislation which many analysts feel may be more important for stimulating (small) business investment than tax incentives that are only valuable once a business is established and earning (accounting) profits. Yet, EZ legislation contains the only proposals that are targeted geographically. Thus, within the present tax policy context, it is difficult to determine whether EZs will hold a comparative advantage over other areas competing for business investment and new jobs.

2. Recent Empirical Evidence Still Suggests Strongly that Tax Incentives Are Not Significant on a Broad Scale.

The recent empirical evidence reviewed in this paper suggests that financial incentives remain at best a "tie breaker" once a general location decision has been made. The use of tax incentives should not be confused with the need for creative financing and access to venture capital required to encourage business start-ups, particularly where capital markets may not be working effectively. The most recent research (e.g., Jacobs-Wasylenko, Schmenner), has pointed to such factors as crime (reflected in high property insurance costs) and land clearance costs as primary deterrents to inner-city investment.

3. Tax Reform Measures Should be Judged Relative to the Desired Objectives of Economic Development.

The primary objective of economic development remains job creation for target populations, and tax base enhancement for target localities. As the analysis in this paper suggests, we can expect different types of companies (classified by "age," size, sector, type of ownership) to respond to proposed incentives to varying degrees. The essence of economic development at the practictioner level will remain creation of appropriate public/private partnerships and acquisition of skills required to "do business deals" and understand the dynamics of local, state and Federal politics.

4. Present Research Must Focus on Specific Types of Businesses (at the Company or "Micro" Level) and Their Likely Response to the Types of Incentives Being Proposed.

Whether one's "gut feel" is to be an advocate or opponent of Enterprise Zones, particularly as a cornerstone of urban development policy, little hard research has been conducted with which to obtain perspective. The most readily available data source is published by the Internal Revenue Service (Statistics of Income), and it contains data for corporations, partnerships and sole proprietorships. However, while companies are clustered in certain ways (e.g., by sector, size class), the data are quite aggregate and generally lag 4-5 years, and certain cost categories are not provided. Given that hearings on EZ legislation are shceduled for Fall 1981, it is essential that more detailed, micro-level analyses be conducted rapidly and read into the official record so that informed decisions regarding investment and employment incentives, and their targeting by income/skill group and geographic area, can be made.

LIST OF FOOTNOTES

1. For a detailed analysis of the Economic Recovery Tax Act of 1981, see the Coopers & Lybrand publication, An Analysis: 1981 Tax Legislation. See also the report of the Northeast-Midwest Institute (Mary Fitzpatrick and Peter Tropper, Authors), Tax Cuts for Business: Will They Help Distressed Areas? (Washington, D.C.: The Institute, September 1980) for a detailed analysis of the impact of depreciation/investment tax credit proposals on investment in distressed areas.

2. The Kemp-Garcia Bill was reintroduced on June 3, 1981, as HR 3824. Two other EZ Bills were introduced in the House on April 1, 1981: (1) HR 2950, "Targeted Area Revitalization Act" (Rep. Rangel), and (2) HR 2965, "Enterprise Development Act of 1981" (Rep. Nowak). Mr. Rangel's Bill amends the Internal Revenue Code of 1954, while Mr. Nowak's Bill amends the Public Works and Economic Development Act (PWEDA) of 1965, the Small Business Investment Act of 1958, and the Internal Revenue Code of 1954. Mr. Nowak's Bill is the only EZ proposal referencing PWEDA and contains features of his "Job Expansion and Urban Development Tax Act of 1981" (HR 390) introduced on January 5, 1981. Senators Heinz and Riegel introduced another EZ Bill, S 1240 (Urban and Rural Revitalization Act of 1981") on May 20, 1981.

3. These types of incentives have been analyzed in greater detail by Paul Pryde and Steve Davidson of the National Rural Center in several unpublished memoranda. They are contained, in the "Omnibus Small Business Capital Formation Act of 1981" (S360).

4. The Targeted Jobs Tax Credit (TJTC) program will end December 31, 1981, if not reauthorized. While Reagan Administration officials recently testified that the program should not be reauthorized because the incentives have not stimulated hiring, several public and private sector groups (e.g., state employment agencies, National Association of Manufacturers) have argued that the program should be extended with more flexible eligibility rules and increased credit ceilings.

5. Jacobs, Susan and Michael Wasylenko, "Governmental Policy to Stimulate Economic Development: Enterprise Zones," paper presented at the Conference on Financing State and Local Governments in the 1980s, Chicago, Il., January 1981 (unpublished).

6. Revzan, Lawrence, "Enterprise Zones and Site Location: How Important Are the Proposed Tax Policy Changes?" Paper presented at the National Conference on Enterprise Zones,

Atlanta, Ga., February 1981 (unpublished). This subject is also covered in the Jacobs-Wasylenko paper. See also, Advisory Commission on Intergovernmental Relations (ACIR), Regional Growth: Interstate Tax Competition, Washington, D.C., Report No. A-76, March 1981.

7. U.S. Department of Commerce, Economic Development Administration, Industrial Location Determinants 1971-75, Washington, D. C. 1973.

8. Industrial Development Research Council, The Industrial Facility Planner's View of Special Incentives, Atlanta, Ga.: The Council, 1978, 17th in a series (out of print).

9. Industrial Development Research Council, A Composite Case History of New Facility Location, Atlanta, Ga.: The Council, 1978, 19th in a series (out of print).

10. U.S. Congress, Joint Economic Committee (D. Matz), Central City Businesses - Plans and Problems, Washington, D. C., 1979.

11. Loc. Cit.

12. Schmenner, Roger W., "Location Decisions of Large Firms: Implications for Public Policy," Commentary, Washington, D.C.: National Council for Urban Economic Development, Vol. 5, No. 1, January 1981, pp. 3-7.

13. Loc. Cit.

14. Loc. Cit.

Mr. **Revzan**. It is our distinct pleasure to be here to present our observations and recommendations on legislation designed to aid economically distressed areas. I would like to point out that Coopers & Lybrand has not taken a position on any of the specific enterprise zone bills introduced in Congress. Thus, rather than focus on any of the particular bills in the narrow sense, our remarks today are directed toward the types of initiatives which we feel are vital to the success of any legislation dealing with economically distressed areas.

The six most important points are as follows: I would like to acknowledge several of these points that were made in your opening remarks. First, the legislation must address the need for infrastructure development. Without adequate roads, utilities, and prepared sites, it is unlikely that significant development can occur in distressed areas.

Second, the legislation must address the important role of small businesses in the economic revitalization of distressed areas and their need for capital at reasonable rates and under favorable terms.

Third, so-called enterprise zones must provide tax incentives that have a significant differential impact on business performance. The Economic Recovery Tax Act of 1981 provides for many of the same types of tax incentives offered in enterprise zone legislation, without imposing any geographic restrictions on investment. To have any chance of providing a net contribution to the economics of distressed areas, enterprise zone legislation must incorporate significant incentives to prospective businesses and investors to provide a comparative cost advantage over alternative sites.

Fourth, incentives should be directed to cost reduction and improved cash flow or topline management as opposed to bottom line ax-reduction measures. Incentives that reduce the cost of capital and wage costs are more likely to be effective than added investment tax credits and targeted jobs tax credits, both of which the small business may be unable to use.

Fifth, the types of businesses targeted for the program should be labor intensive and not necessarily high technology oriented. Research indicates that distressed areas are more likely to be attractive to labor intensive small business seeking to expand than new, high technology oriented ventures of a high risk nature. Therefore, incentives should specifically focus on reducing the cost of labor.

Sixth, to realize long-term potential for success, enterprise zone designation should be selective and include areas with a variety of characteristics so that results, and factors contributing to those results, can be carefully monitored.

It is important to point out, we believe, that the Enterprise Development Act of 1981, as introduced by Representative Nowak, is the only bill that recognizes explicitly this need to combine programs that stress infrastructure development and availability of low-cost capital for small business with tax incentives.

Let me now turn to specific incentives most likely to be effective and satisfy policy objectives. In this regard, our first point is that there are two types of incentives not addressed in the Economic Recovery Tax Act of 1981 that could be effective in stimulating investment and employment in distressed areas: Tax incentives to investors—particularly in small businesses—and wage credits to stimulate employment. There are a number of proposals that address tax incentives to investors in small businesses. These include an income tax credit for investment in original issue stock, nonrecognition of the gains from sale of incentive stock—if rolled over—and use of the small business participating debenture. We feel these incentives could stimulate direct investment in small businesses and would complement such existing programs as small business investment companies and SBA section 503 local development companies that sell Government-guaranteed debentures to finance direct loans to small businesses. In the area of wage credits, the Economic Recovery Tax Act of 1981 has extended the use of targeted jobs tax credits—TJTC's—through 1982 and liberalized eligibility criteria. If these credits are to be used, and we question their potential effectiveness, they should be increased enough so that locating in an enterprise zone will provide a significant differential in the net wages paid by businesses. The Targeted Area Revitalization Act introduced by Representative Rangel provides the widest range of wage credits for this purpose.

Our second point is that to the extent that tax credits are utilized, they should be refundable for small businesses. Owner entrepreneurs are most likely to respond to operating cost savings. Therefore, it would be more effective to focus on direct labor cost reductions—for example, through reduced social security contributions and/or reduction of the minimum wage—and capital access/cost reductions. If investment tax credits and/or targeted jobs tax credits are increased in zones, they must be made refundable to small business if they are to be successful because these businesses generally do not have taxable income during initial operating years.

Our third point is that differences in State and local tax burdens must be considered in zone designation and in providing incentives to businesses to locate in zones. Wide variations exist in business tax burdens among States and within States. Businesses often face higher property tax burdens within inner-city areas than in suburban jurisdictions, and this situation can exist also for income taxes—for example, New York City. As a result, these differentials could offset the Federal incentives being offered unless local tax relief—where constitutionally permission—or a State tax credit is provided. Connecticut's newly passed enterprise zone bill is a good example how State and Federal incentives can work in tandem to achieve economic development objectives.

To summarize, we recommend that the following points be considered by this subcommittee in finalizing its enterprise development bill as part of a broad economic development strategy: First, the linkage of tax incentives to infrastructure development, capital access, and employment training should be stressed and strengthened, and forms of assistance should be highly targeted.

Second, enterprise zone incentives should be directed toward labor-intensive businesses and should focus on job creation for the unemployed and underemployed.

Third, specific incentives should focus on labor, capital, and land cost reduction where practicable; in cases where bottom-line tax credits are offered, they should be refundable for small business.

Fourth, enterprise zones must offer significant differential benefits from those provided in the Economic Recovery Tax Act of 1981. Increased incentives to investors in small businesses and a strengthened form of targeted job tax credit are two examples.

Fifth, State and local tax burdens must be considered in a targeting strategy, and States need to provide tax reductions and added financial incentives to businesses locating or expanding in zones to offset higher operating costs and tax burdens.

Finally, it is also crucial to consider the role played by State and local government personnel in stimulating investment in distressed areas over the last several years. The unique forms of public-private partnership that have emerged are perhaps as significant as the financial incentives that have been offered. Withdrawal of the Federal Government from participation in these capacity building efforts could be detrimental to the developmental objectives that this legislation seeks to attain.

We appreciate the opportunity to testify on enterprise development legislation and look forward to working with the members and the staff in the future. We would be happy to answer any questions that members of the subcommittee may have.

Thank you very much.

Mr. NOWAK. Thank you. Mr. Jones, would you like to add anything to the statement?

Mr. JONES. Not at this time.

Mr. NOWAK. Let me turn to Mr. William Barrow and take your testimony.

Again your testimony will be included in the record and you may proceed as you so desire.

TESTIMONY OF WILLIAM J. BARROW, DIRECTOR OF BUSINESS INVESTMENTS, AMERICAN ASSOCIATION OF MESBICS

Mr. BARROW. Mr. Chairman, as director of the business investments for the American Association of MESBICS I am here to present the association's views concerning alternative approaches and policies for small business job creation and urban revitalization.

Since this will go in the record I will be brief in terms of our review of the material.

I can start off by saying that the small businesses have had to overcome a number of obstacles. I am not going to try and organize them in terms of first, second, third, or fourth as some of the people have done. We have constructed our own study and we have come to realize that capital retention in the case of the businesses we deal with primarily which are minority owned and controlled businesses is a No. 1 problem.

The second often cited problem is in our study. We conducted our study regionally and we can make a copy of that available to you. We should have a final of it by Friday of this week. We were able to determine the availability of skilled qualified labor was a major problem. When we looked over the incentives that had been offered in the past under the urban enterprise zone we found that we did not feel as though they had done enough.

We have had extensive involvement with the Economic Development Agency in the past and found it to be helpful in managing the dollars we have. All the funds we have funded using EDA dollars, the people are paying their loans back. They are current in their debt service. It was able to make projects doable which were considered projects that were unbankable or people were not creditworthy at that particular time.

What we basically are proposing today is—I would like to start with the targeted jobs tax credit—I have had some involvement with that since 1975 when I started with the Arthur Andersen accounting firm and we looked at the effect of a tax credit. It sort of boiled down to one of the basic economic principles in terms of how much are you willing to give up to give someone an incentive to make the investment. We found it was not adequate.

Earlier in today's testimony it was noted a number of people said there was not a relationship between the credit that was offered and the actual cost of training these people. So what we are proposing is that that gap be closed. In this particular paper, just the ball-park figures were around 60 percent in terms of the cost of investment. That would change according to the industry and I don't know if that is too high but the main point I am trying to stress is that it was not adequate. The tax credits have worked in the past and it seems as though whenever you talk about the people that have the least amount of disposable income in building things in America, that the issue always comes to bear that something is not effective.

We do feel tax credits are effective and it should be expanded. We think also the provisions which require that you have to have other mechanisms, you have to use other credits prior to that, are also detrimental in terms of encouraging the investment in manpower. We would like to see those limitations removed so that a person could have access to this credit immediately. The other areas of concern that we have in terms of the enterprise zone is that we feel investors have not been adequately stimulated in the past to make investments. That is where you are asked to take a greater risk, you have a higher risk in terms of the cost of capital going into the inner city, the people you are investing in, the business opportunity. You basically and usually in the ordinary business scenario require a greater return. We feel that the people should be able to receive a greater return on this investment. We propose a credit to those people that are investing. We noted the financial institutions as well as some of the other companies don't use the credit they have to the extent they have. I don't think it is a question they would not use it if you made it advantageous for them to use it. But they have not done that. We are suggesting that in all instances, or in the particular instance where you have the need to increase the amount of money that you are stimulating. Finally, in terms of the targeted jobs tax credit, we noted some are in favor of basically having a requirement that you take people that are in a certain target group so that they are employed. Some other proposals we have heard especially on the Senate side, they said first let's get the investment in this particular area. Then after we get the investment we will work backwards and find a mechanism to include a certain target percentage. I think what they are relying on would be that the employer would have some sort of conscience and they would do this. We would like to see a mechanism where they are required to take a certain percentage of unskilled people and put them back to work in the job force. That concludes my testimony.

[Mr. Barrow's prepared statement follows:]

PREPARED STATEMENT OF WILLIAM J. BARROW, DIRECTOR OF BUSINESS INVESTMENTS, ON BEHALF OF THE AMERICAN ASSOCIATION OF MINORITY ENTERPRISE SMALL BUSINESS INVESTMENT COMPANIES

Mr. Chairman and Members of the Subcomitttee, my name is William J. Barrow. I am the Director of Business Investments for the American Association of MESBICs. I am here to present the Association's views concerning alternative approaches and policies for small business job creation and urban revitalization.

The American Association of Minority Enterprise Small Business Investment Companies (AAMESBIC) represents MESBICs throughout the United States. Created administratively in 1969 and through legislative mandate in 1971, 301(d) SBICs, commonly known as MESBICs, are specialized for-profit venture capital vehicles licensed and regulated by the Small Business Administration to invest in small business concerns owned by minority entrepreneurs. MESBICs are a unique private-public sector partnership instrument utilizing the preferred stock and debentures purchased and issued by the Small Business Administration to leverage the financing capacity of minority deals.

By late 1980, there were approximately 129 licensed MESBICs representing a total of over $178.4 million in investments. In 1980 MESBICs made 547 financings totalling $42.2 million. The average firm financed employed twenty people with gross sales of $800,000. Approximately 50 percent of these firms are located in the inner-city. As a trade association representing investment companies which invest heavily in inner-city businesses, we are very interested in the subject of today's hearings.

Historically, small business has been the primary source for new jobs, especially those jobs that can be filled satisfactorily by the work force that occupies the central city, which tends to be composed of low- or un-skilled labor. It is to small business, then, that we must turn for inner-city job creation and urban revitalization.

Unfortunately, many, if not most, small businesses must overcome obstacles to capital retention, expansion and formation which result from the unavailability of capital. Removal of this barrier will decrease unemployment and underemployment by accelerating the rate of enterprise formation and expansion.

Several methods have been proposed to help solve this problem, including the Urban Jobs and Enterprise Zone concept. Our association views such items in this bill as the elimination of capital gains taxes on investments within the zone, the exclusion from taxation of 50 percent of all earned income and income on interest earned on loans within the zone, and the extended 20 year loss carryforward as steps in the right direction. These will help fulfill the need to build those investment vehicles which have already exhibited their commitment to creating successful businesses that will employ, and thus build the infra-structure in the inner-city. The key to the whole Urban Jobs and Enterprise Zone concept is to leave the community in a stronger, more self-sufficient condition.

Local and state involvement in urban revitalization is an extremely important factor. One method of participation could be the contributions and/or sales of land at low costs by the local government to small businesses. Besides helping to cut the costs for the entreprenuers, this measure would also help attract more captial to the deal as an additional asset. Another local effort would be the targeting of local development corporations' and/or similar financial groups' resources to businesses in this area in terms of technical assistance, loans and grant funds.

Additionally, it is important to note that legislative action on the following incentives would attract new ventures as well as maintain old ones, reduce the risk associated with investments in younger and smaller firms, and reduce the cost associated with underwriting the incentives to stimulate employment by stimulating small business.

Both the existing 10 percent Investment Tax Credit and the targeted jobs tax credits should be made refundable to target companies. A good way to reduce labor costs is to change the Targeted Jobs Tax Credit so that it more adequately reflects the cost incurred by the business.

As this law is presently written it acts as a disincentive to firms in that the value of the credit does not adequately contribute to the actual cost of training these often unskilled and higher risk persons. It is suggested that the employer be able to receive a tax credit of up to 60 percent of training cost and removing such restrictions as the credit be available only after other tax credits are used and that the employer's wage deductions be offset by the amount of the credit. With these changes, the value of the Targeted Jobs Credit would be more valuable to small firms than present law.

The government should also allow the postponement of all taxes on gains from the sale of investments in eligible companies when the proceeds of the sales are reinvested in targeted companies. Additionally, federal legislation should target these small companies that can help solve the unemployment, train skilled workers and focus the resources of either present programs—EDA and UDAG, or the proposed enterprise zone program.

A tax credit with a cap could be given to investors that invest in companies doing business in the zone. The advantage to the community is the investment of dollars into the target area either directly in companies located in the zone or through other investment vehicles such as SBICs, MESBICs, etc. The investment could take the form of direct dollars or guarantees which would serve to lower the cost of capital. Note: Where a bank makes a loan of funds to companies located in the target area, they would receive a credit only where they invest the money through an investment vehicle such as a MESBIC. This investment would count toward meeting CRA requirements.

As I have already mentioned, state and local incentives should be used to supplement federal incentives, for example, seed capital funds, guarantee loan funds, low cost loans, and assistance with building renovation. They might also help to sponsor training programs for adults and youth, both skilled and unskilled, to increase employment and decrease underemployment.

The effects of these incentives is that they would increase the investment in small firms and new firms and stimulate investment in investment corporations, which provide funds to these companies. The companies, in turn, employ both skilled and unskilled workers. These suggested incentives can be used in conjunction with present programs such as the UDAG and EDA programs with "pockets of poverty" criteria or in conjunction with the proposed enterprise zone legislation utilizing suggested modifications in incentives, which have very worthwhile objectives.

AAMESBIC believes that merely providing these incentives to business will not be beneficial unless firms have a reasonably high percentage of targeted individuals. We therefore suggest that either a certain percentage of the individuals hired be unemployed for a period of time, or if the proposed enterprise zone legislation is used, target firms that hire a high percentage, say 40 percent, of the targeted individuals. These individuals would include unemployed as well as those hired in skilled labor areas where there is a shortage. This last element would give rise to training programs for adult workers as well as youths. In both instances, it presents a savings for business and a job opportunity to those in need.

In summary, the key to urban revitalization is small business job creation. An increase in the number of small businesses necessitates a higher availability of capital to the small business sector. AAMESBIC hopes the subcommittee will consider the options to achieve increased capital availability that we have presented today, and we appreciate the opportunity to testify on this very important matter.

Mr. NOWAK. Thank you very much.

The other witness this morning brought up the problem of people being trained at a severe cost, especially to a small organization, and then losing the well trained or skilled employee to a larger or different type of structured corporation. Have you run into that kind of a problem in any of the corporations you are involved with?

Mr. BARROW. We find that that is a problem. There are a number of problems. First whenever we acquire a business there is always that question as to whether or not minorities have the capability of running that business as effectively. So the employees are somewhat distressed. We have been able to stem part of the problem and some people have stayed on. A primary example is a deal we completed in East St. Louis, repair of railroad manufacturing. The majority of the employees were willing to stay. The major problem is a majority of them were in their fifties. The problem is where are we going to get the people to replace those people so that the business can continue to run at its high quality. That is probably one of our major problems. They don't have a training program there. It almost caused the deal not to be done. They have basically exceeded their projections by 40 percent.

They are going over $8 million in business this year. They are hoping to bring on some more people but to pull someone off the lines to train someone else is a costly problem. The other thing is in terms of the competition that they have from other companies. It has not been as much in that particular industry because our competitors would be in the Texas area so we have not had the same thing where they come around on the parking lots and put bulletins out.

In terms of the high technology and the computer manufacturing, we just had a firm that received a $100 million contract with the Federal Government. The problem they are going to have is attracting qualified people. Many of the people fortunately they have been getting have been from Arthur Andersen or Price Waterhouse where they brought someone in, invested a large amount of money in these people and they have been fortunate enough to give them a higher wage than they could ordinarily command being able to attract this particular talent. I think what you have to look at in terms of our community, we are talking about a handful of firms who are only able to do a small job. Our investments totaled $121 million last year. That would not put us in the top in terms of the largest investment companies.

Mr. NOWAK. When you look at the problem of training—you brought out the problem that whether it is very highly skilled trades or a day labor CETA program type of individual that comes in, they have to have the basic math, basic skills to qualify for the job. Have you in your experience run into that as a particular problem, where people are not able to perform the work or you are not able to attract people to those jobs because the people applying don't have those kinds of skills. Is that a particular kind of hardship to try to fulfill in a distressed area?

Mr. BARROW. I would say it is not a distressed area when you consider the fact over 50 percent of our business investments since 1976 have been located in distressed areas.

We don't have any type of training programs in terms of the investment companies so there has to be a demonstrated ability to find qualified employees. If you have 30 positions open, you have to have those 30 people basically ready to go. We looked carefully in terms of their background. So we are looking at basically the cream of the crop in that particular area. Another thing is that just because we deal with minority businesses we do not limit our hiring to that. We are looking at the best qualified people. Even in that we find it difficult to attract. In terms of top management we have not had as much of a problem because we are willing to give up more of a piece of the action. The way MESBICS' are constructed we are not able to take the same position, the equity position that is equal to our investments. So in other words we cannot walk in and take 60 percent of a company. We have to allow them the buy-back provision. Our position is it is most generally 40 percent. Over a period of time, 5 to 7 years, they are able to buy us out so there is a lot of play in there for various types of incentive programs to motivate those people who are management-type people. And they want to keep them.

Mr. **Nowak**. Mr. Jones or Mr. Revzan, would you comment. In your statement you mention that tax incentives should favor labor-intensive businesses.

What types of businesses are you talking about in that testimony?

Mr. **Jones**. I think you would be talking about labor intensive as opposed to capital intensive. That is the way we meant it and those which emphasize more toward the unskilled rather than the skilled. For example—in the New York area that I am familiar with—you might well be talking about light industry, electronic components, assembling things. Where the amount of training is minimal to get someone operative. You might be talking about toys in the Northeast. You might be talking about apparel and textiles where the amount of training is done substantially on the job and is a minimal kind of training. Also these are industries that generally do not require a great deal of capital up front to get involved in the business. Many have been highly leveraged for a considerable amount of time notwithstanding the high interest rates. So, for companies in these industries they can much more readily expand, open another unit for example, in an enterprise zone and avail themselves of some of the benefits we are talking about than the so-called newly constructed new business, startup situation that comes up right off the ground. Listening to some of the testimony this morning some of the emphasis, perhaps too much emphasis, I think, is being placed on a brand new business, perhaps with the thought of the technological orientation that a lot of new electronic industries have had. I don't know that that is necessarily the target. I don't know that the incentives that you offer by way of either the job credit or the bottom line tax credit is so significant to an industry of that type. If you talk about the other kinds of industries where, with a minimum of development, you can go into a particular area, locate in an area and soak off unemployment because you can tap this unskilled reservoir, I think that is a much more apt target for this kind of legislation. In my discussions with any number of entrepreneurs in the New York area, just testing the water after the Kemp-Garcia legislation was introduced, the answer was generally, wherever we had a labor-intensive situation, small amount of capital required, where present financing could be extended into another unit, these were natural candidates to go in. And they were interested in what this would mean to their business. By the same token, our emphasis is above the line savings rather than tax credit. A lot of these companies through salary structure and through a result of a series of tax acts including the last one, Economic Recovery Tax Act, we don't have a bottom line against which to apply the normal corporate tax, so tax codes per se don't mean much. But above the line, payroll tax credits can be very substantive in terms of the economics of their particular business.

Mr. **Nowak**. You stated that incentives should be directed to cost reductions as opposed to any so-called tax incentives. That distinction really is very important when you look at an expanding business that has been operating for a few years and making a couple of dollars for the reasons you just mentioned here. So we do have a mix of businesses and I think you are right in saying much of the testimony was targeted toward the startup situation which on the other hand needs that working capital to begin with. But it is probably true that the faster job creation and revitalization efforts will exist in those already operating within a sector, wherever it may be. Those with the ability to see a new market with these types of incentives or combination thereof would expand, and I wonder if you could sort of address that kind of an environment. In effect, what kind of a mix could you suggest would probably be the best for your kind of situation in New York City?

Mr. Jones. I think one of the points that we made a moment ago was to put what I would call a safety net under this credit to permit a refundable type of credit even where there is no particular tax applicable because of the nature of the kind of companies that would take the incentive and move into these areas.

I think, by and large, you would have the preponderant portion of companies that would take up the incentive and move into these areas would be companies that probably don't have much of a tax liability right now. I think they would be companies that would not have to go out and borrow extensively beyond their present lines. I think that would be companies that are highly leveraged today and I see them, most of them, being in operation today as opposed to newly formed. I think there would be an emphasis on that. I think the formulation of the piece of legislation should have a mix of both above the line typically the payroll tax reduction and I recognize that is a sensitive issue because of the declining funds and the impact on, for example, the social security fund.

I am not so sure that is an appropriate argument, however, because I think in many instances the kind of unemployment you would soak up does not, is the kind of base from which you don't derive the payroll taxes anyway at this time. I would also think the mix of incentives of refundable credits plus above-the-line refundable parallel tax credits mixed with a combination of State and local tax credits—because that is a problem as well—I think would attract the necessary kind of employers that would indeed soak up considerable amounts of employment. For example, I had occasion to speak to a group of retailers discounters. Significantly they are less concerned with the image of their store and so forth than they are with efficiency. They are not a labor-intensive group but the kind of questions I got at the tail end of that were interesting to me. A number of them were interested in establishing mail-order units. The opportunity to embark on this kind of program within an enterprise zone, pick up a great many people who are otherwise unskilled, train them quickly, make them operative almost immediately and avail themselves of this credit limited to their activity within this area—I think you would attract not only small businesses but large ones as well.

If the objective is to soak up a good deal of this unemployment and get some of the depressed areas going I would not limit the incentive to small business alone.

Mr. Nowak. Let me thank you very much for a very broad and lengthy statement that I think has some very good detail work in it. It has, I think, a very broad appeal and our problem is going to be how to fashion this thing so that it will have the desired impact both on the so-called above the line and below the line and have the kind of incentive that will comply, and not compete with this act as it has passed up to this point in time. One of those factors, of course, that we will be fighting is the type of revenue shortfall that we have. I think you brought out a good point—if the revenue shortfall comes in and you create a job, and you look at the total spectrum of impacts, including any social programs that may be cut off because somebody in the family received employment, the overall so-called loss may be really a gain even with tremendous investment credits. So we are going to look at a mix of these and I think your testimony will be particularly helpful and we will be in touch with you at a later date if we need more detail. Thank you.

Our next witness will be Small Business United, Mr. Stephen Dooley. He will be accompanied by Mr. Robert L. Haddad, who is with Price Waterhouse & Co.

TESTIMONY OF STEPHEN R. DOOLEY, C.P.A., TOFIAS, FLEISHMAN, SHAPIRO & CO., AND ROBERT L. HADDAD, PRICE WATERHOUSE & CO.

Mr. NOWAK. Gentlemen I want to thank you for your patience. I am sorry for the delay. Your statement will be incorporated in the record and whoever would like to lead off please go ahead.

Mr. DOOLEY. Thank you very much, Mr. Chairman.

I am speaking to you today on behalf of the Smaller Business Association of New England—SBANE—a coalition of 14 regional small business organizations that encompasses 25 States.

Small business people, being innovators as well as significant community leaders, are the very fiber of future economic growth. Firms which are less than 5 years old generate 80 percent of all new jobs around the Nation. Despite their unequalled ability to control the regional economy, small businessmen need assistance.

The Economic Recovery Tax Act of 1981 has been of assistance to small business with respect to some of their problems, particularly the changes in the estate and gift tax area.

Although other provisions in the act are certainly helpful with respect to dollars saved and applicability, most of the provisons have been geared to larger companies or very capital intensive businesses.

Conscious of the fact that small business is responsible for at least 80 to 90 percent of all new jobs, SBANE conducted a survey in August 1981, of its members as to their utilization and opinions on the framework for a solution—the untargeted jobs credit—now repealed—and the existing targeted jobs tax credit.

I would like to release the findings of the survey at this time. Small businesses responded to the survey with the following results: When asked, "Do you support reinstitution of the original untargeted jobs credit which applied to all workers?" 74 percent responded yes, 15 percent responded no, 11 percent undecided. "If Congress will not restore the full jobs tax credit do you support continuation of the targeted credit?" 52 percent responded yes, 24 percent no, 24 percent undecided. "Did you use the untargeted jobs tax credit?" 73 percent responded yes, 23 percent no, 4 percent undecided. "Did you or are you using the targeted jobs tax credit?" 34 percent indicated yes, 58 percent no, 8 percent undecided.

As reflected in this survey, Small Business United supports the reinstatement of an untargeted jobs credit. We support the reinstatement of an untargeted jobs credit because the credit did what it was designed to do—serve as an incentive to increase employment for the small business community.

The Treasury was quoted in Business Week—August 21, 1978, pages 23-25—that based on only a portion of 1977 returns, 522,000 additional jobs were created. This is a rather startling statistic when you consider that most small businesses were unaware of the tax credit during 1977—its first year of operation—and many were not aware of it or its implications until March 1978, almost 1 year after enactment.

In an analysis of a Department of Labor financed, Bureau of Census questionnaire mailed in February 1978, lack of awareness by small firms is evidenced by the fact that only 27 percent of firms with less than 10 employees knew about the credit.

The fact that the untargeted credit was successful is supported by an earlier survey conducted by SBANE in 1978 among 60 of its member CPA firms. To a person they related examples of smaller businesses who were deriving a benefit from the jobs tax credit in the form of adding new positions. However, by the time small businessmen became familiar with the mechanics of the credit and how they could incorporate it into their overall corporate planning strategy, it was repealed.

Although there were other operative factors such as fiscal and monetary policies, the unemployment rate dropped from 7.7 percent in 1976 before the untargeted credit to 7 percent in 1977 and 6 percent in 1978, the final year of the credit.

There is no question that the untargeted jobs credit did provide a windfall in certain instances to businesses that, unaware of the magnitude of the credit, happened to be expanding at an opportune time. However, the method of utilizing a credit directly geared to an increase in employment is basically sound and should not be discarded because some people were more fortunate than others. If given the opportunity, the private sector can provide these jobs without bureaucratic red tape and at less cost.

In the SBANE survey, only half of the respondents indicated that they would be supportive of continuing the targeted jobs credit even if the untargeted jobs credit were not reinstated. As indicated in the survey, most people did not utilize the targeted jobs credit. The comments received clearly indicated that this system was perceived as too burdensome to administer.

One employer, a Massachusetts trade show exhibitor with 35 employees, commented that "I hire people based on their capability and attitude, the targeted jobs tax credit has no bearing on who will be hired."

An electronics manufacturer with 65 employees summarized many of the comments when he said that "As far as small business is concerned, there are not enough targeted employees to offset the cost of filing for them." Several CPA firms also responded and all indicated that while the untargeted jobs credit was used by their small business clients and resulted in more jobs, the targeted credit was a mistake in that it was too detailed and complex to deal with.

A new untargeted jobs credit should include several modifications on the original credit—which will make it even more effective. First, the limitation for each corporation should be lowered from the previous $100,000 per year to $50,000. Second, the computation of the credit should be reduced to 35 percent of the increase in Federal unemployment wages rather than the previous 50-percent credit.

Third, the time period should be for at least 4 years rather than the previous 2-year period—1977 and 1978. The reduction in the limitation will greatly reduce the likelihood of companies experiencing a windfall. The long time period during which the credit can be earned will mean that more companies will be able to plan for and utilize the credit.

Fourth, there should also be sufficient lead time such that employers can factor the untargeted credit into their expansion calculations. If the untargeted jobs credit could not be introduced under these circumstances, possibly businesses could have the opportunity to elect either: (1) the investment credit or the untargeted jobs credit; or (2) a combination subject to an overall limitation or percentage reduction in investment tax credit for the jobs credit claimed.

Small businessmen will not hire new people solely for employment tax credits any more than they purchase equipment solely because of the investment tax credit. However, in both cases the tax credit will be an important factor. While labor intensive businesses will not benefit directly or significantly from the new accelerated cost recovery system in the act, those benefiting from investment tax credits receive the credit for simply replacing equipment while those benefiting from the untargeting jobs credit can qualify only if they create a new job.

Even in those situations where the employment credit does not directly create new jobs, it has an anti-inflationary impact in that it is offsetting higher minumum wage and increased payroll taxes. We provide the employer a credit for purchase of machinery but increase his payroll taxes when he increases his work force.

Implementation of the untargeted jobs credit will be of major assistance to small businessmen who need skilled laborers. The cost of training is very expensive, especially when trained employees leave to work for larger corporations offering higher pay and benefit packages. The credit would lower the costs to these small businessmen allowing them to hire and train motivated personnel and thus remain competitive with larger corporations.

In summary, Small Business United has no strong objection to the continuation of the targeted credit, especially, in light of the important social objectives which it attempts to fulfill. The credit and its implementation need to be simplified and publicized more for it to be effective. However, successful in these respects, its inherent complexity and red tape will not make it cost justifiable for most small businessmen to become involved and, therefore, the targeted credit will not stimulate growth of the small business sector.

Small Business United strongly believes that more jobs can be created for less money without red tape by the private sector. We support an untargeted jobs credit with certain reductions and modification, which when used with other tax legislation and economic incentives, will allow it to be a more successful catalyst both of small business capital formation and increased employment.

Thank you for inviting Small Business United to express its views on the subject of job creation and revitalization of small business.

Mr. Nowak. Thank you very much.

Mr. Haddad, would you like to add anything?

Mr. Haddad. I have no comment at this time.

Mr. Nowak. This last job, so-called tax credits that were passed had a little problem I think in implementing those regulations. Do you know when those regulations were finally implemented?

Mr. Dooley. I know it was not put into effect until May 1977. The regulations came out a substantial period of time after that. I don't know the exact time but I can tell you from practical experience in dealing with small businessmen that most small businessmen clients, my own included, were not aware of the original untargeted jobs credit until at least March 1978, when they first began preparing their corporate returns for 1977 and their accountants were preparing returns and in many cases for the first time they were becoming aware of the jobs tax credit. We would like to see sufficient leadtime so they could take this into consideration.

Mr. Nowak. There was very little publicity that was generated out there in the field. I think what we are trying to do is put some type of general credit together with these other initiatives and make some real sense and bring as broad an impact as we can on the small business community.

This is one area I think is very important. Everybody talked about the skilled labor problem and how we are going to solve it. That is very critical in some industries. In other areas such as a very labor intensive industry, I think this jobs tax credit could provide a very important lift to a corporation. I guess the administration is looking at the problem of putting together a mix. We see there are a lot of conflicting kinds of incentives that may look good to one type of structure but won't affect another, and how are you going to have something universally of some benefit.

I don't know how we can overcome this interest rate problem, in the short term, at least. It is a drag on any incentive that we put including the one we have already passed. So many people you have talked to look at the bond market and the stock market and have been totally discouraged when they can invest their money at 17 or 18 percent, and I assume a lot of new construction or modernization or expansion is being delayed for the same reason.

If they do have the cash it is pretty tough to turn down 17 or 18 percent without blinking your eye. On the other hand, if there are markets, how many more incentives do we need? It is a difficult problem to try to specifically try to figure out what will make the most sense to the whole community.

We appreciate your testimony. We may have further questions. I have to go back to the House floor and vote or I won't be reelected to come back and ask the questions. We do appreciate your coming and taking the time to testify.

In the next 2 or 3 months I think there is going to be more focus on doing something in this area. Especially if we can generate some thought with the administration to bring a package together with the mix of things we talked about this morning. Certainly I am a firm believer that the jobs tax credit has come real place in all of this. We appreciate your assistance. I hope that you will be available, if not here in Washington, so we will be able to correspond and get any other material that we feel will be useful in trying to prepare a total package.

I sincerely want to thank you. We will recess these hearings until Tuesday, September 22.

[Whereupon, at 2:10 p.m., the subcommittee adjourned to reconvene on Tuesday, September 22.]

JOB CREATION AND THE REVITALIZATION OF SMALL BUSINESS

TUESDAY, SEPTEMBER 22, 1981

House of Representatives,
Subcommittee on Tax, Access to Equity
Capital and Business Opportunities,
Committee on Small Business,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:40 a.m., in room 2359–A, Rayburn House Office Building, Hon. Henry J. Nowak (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN NOWAK

Mr. Nowak. The subcommittee will come to order.

Good morning. We are here to continue the hearings on urban revitalization, the lack of skilled labor, training and available skills in our business community. We welcome everyone here to the second day of hearings.

What we are trying to do, of course, is fashion an urban strategy to bring about the incentives that are necessary to allow our small business communities to go forward and expand. We need to provide the type of jobs that make a difference in bringing about the urban revitalization that is necessary to uphold the quality of like in our older communities.

We have heard testimony that broader measures than just tax incentives are needed for small business and communities to expand, and it has been suggested that we combine tax code incentives with the other types of incentives. We have looked at the problem of startup capital or working capital, and the need for infrastructure improvements, to create the total environment for that kind of job expansion and creativity.

The lack of skilled labor is a major part of the problem, because without a sufficient amount of skills in a community, of course, business will have a hard time expanding. Businesses already in place, and the activities of cities in bringing in new industry and new business is tied into that whole environment, and so we are trying to look at a broad spectrum of things.

Hopefully, these hearings will elicit from the many experts that will be testifying today suggestions that not only this Congress will be interested in, but which will also be of help to the Administration as they work to forge an urban policy for additional reductions in some Federal programs, and also their consideration of the defense cuts.

I am very happy to welcome all of you here today, and I know that many of you have looked at this problem in great detail in your individual communities and have studied this as a national problem. I think your testimony will be of great help not only for the members on this committee, but even broader than that, for all the Members of Congress.

Our first witness will be Hon. Moon Landrieu, former mayor of New Orleans. Mr. Landrieu, if you would like to come forward. I am sure you need no introduction to anyone—in New Orleans or in Washington—as the former Secretary of Housing and Urban Development from 1979 to 1981. Your background certainly qualifies you extremely well to speak on this subject, as a former mayor and former Louisiana State legislator, as well as, I believe, the chairman of the League of Cities. So we wanted to thank you for your presence.

Your prepared statement, of course, will be incorporated into the record in full and you may proceed as you desire.

TESTIMONY OF HON. MOON LANDRIEU, FORMER MAYOR OF NEW ORLEANS, FORMER SECRETARY OF HOUSING AND URBAN DEVELOPMENT

Mayor **Landrieu**. Thank you, Mr. Chairman, and the committee, for the invitation.

We are concerned about developing and maintaining an urban strategy. You and I come from quite similar cities, both very old cities, yours perhaps a little colder than mine, but nonetheless, two great cities. I think our visual observations tell us that while these cities have had a great history and hopefully a great future, that they do need assistance and help. They do need good leadership and good management. And by that, I don't mean to suggest it is absent. Not at all.

It simply means that cities today need all the tools and imagination that are available to them in order to overcome some of the deterioration that has been caused by past Federal and State policies.

I will submit my statement for the record, Mr. Chairman, with your permission, and just make a few broad comments about the concept with which we are dealing today.

Without hesitation, I support the urban enterprise zone concept. However, I think we should make it quite clear that it is only one tool in the workbox that is going to be necessary. We oftentimes develop a new approach or new strategy and believe, because we're enthusiastic, that this is the answer. I don't think the chairman suffers from that illusion, but just as a cautionary measure I mention it. Because in my experience of 20 years, the problems of cities are so complex that no one item, no one program, no one strategy, is going to work for all cities, nor will any one turn around any particular city.

We have worked for a long time with urban renewal, with model cities programs, poverty programs, community development, urban development action grants and a multitude of others. I am happy to say that for the most part those programs have worked. We see the evidence of that here in Washington, D.C. We see it in New

Orleans, we see it in Baltimore, Chicago, New York, and I am sure also in your city and many others that I need not mention.

There is a great revitalization taking place, but that revitalization is only a beginning. It is not to be suggested that it is an end and that the job has been completed. The problem that I have with the enterprise zone concept is that without the other tools, I am afraid it is not going to be very effective.

Coupled with the availability of capital, coupled with grants, coupled with the ability of the cities to provide the necessary infrastructure, job training and a multitude of other things, the concept, if properly framed in legislation, will work. But it will not, in my judgment, work standing alone. My fear is that as we cut back the other programs that have been working so effectively for the past 10 years, and put in place thereof an urban enterprise zone strategy, that those who advocate the cutbacks will rely entirely upon the enterprise zone to produce the kind of redevelopment that cities need. I am firmly convinced that in and of itself it will not work that way.

One of the things that we find in working with cities is that up front capital is essential in order to attract people into depressed areas. We do live in a very discriminatory economic society, and that system responds to the profit motive. I don't mean to suggest that it doesn't have a social conscience, but by and large it has to respond to the economic system and it has to produce a profit. Without the anticipation of that profit, there is very little hope of venture capital.

All the tax incentives in the world will not assist and will not encourage an investor. Assuming that the incentives are attractive, if in the final analysis they do not produce a profit or a reasonable return on investment, that investment is not going to be made.

You have two types of investments—and I don't mean to be elementary, but I think sometimes we forget it. One is the venture capital, put up by the entrepreneur, and the other is the loaned capital. Both are concerned about the health and profitability of the business. One has potential for the long run, a great risk and perhaps great return. The other has a more steady return and is looking for the swiftness or the sureness of the return of that dollar.

Where there are competing business opportunities that assure safer or will produce the potential for greater return, the dollars will inevitably find their way into those locations.

The new tax reductions that have been granted make this kind of approach less attractive, though still attractive as an alternative, or at least as another method to be coupled with those currently in existence.

On a few specifics, Mr. Chairman, I think the program first of all ought to be fairly broad if it's going to have any meaning whatsoever. I don't think that it should be left to the discretion of the States. While I think some guidelines have to be placed, I think it is imperative that those guidelines be Federal guidelines and that the States not have a veto power over the location or the definition of those zones.

Second, or third, I think there has to be a definite linkage between this program and the others which are currently in existence. Now, how that is to be maintained in the face of the cutbacks, I really have no great answer for. Only a caution, that while they may be used as experimental or laboratory tools, I have very little hope that they will work effectively without the availability of the other Federal programs.

Mr. Chairman, that sums up about what I have to say, other than to answer any questions which you may have.

[Mr. Landrieu's prepared statement follows:]

PREPARED STATEMENT OF HON. MOON LANDRIEU, FORMER MAYOR OF NEW ORLEANS, AND FORMER SECRETARY OF HOUSING AND URBAN DEVELOPMENT

Mr. Chairman and Members of the Subcommittee, I am Moon Landrieu, the former Secretary of Housing and Urban Development and the former Mayor of New Orleans. I have served also as President of the U.S. Conference of Mayors and have been active in the National League of Cities, the two major lobby groups for local officials. I am pleased to appear before you today to discuss the concept of urban enterprise zones.

Mr. Chairman, I know you come from Buffalo, a city that may get a bit colder than New Orleans, but also a great city like my own town of New Orleans. Both of these cities also have problems. They are cities that need good management and imaginative leadership. They are also cities that could profit by what we are going to discuss here today. Once again, thank you Mr. Chairman for having me testify before you today.

Mr. Chairman, let me also state that I am sensitive to the charge of this committee's responsibilities to small business and I think it is correct and proper that you are holding these hearings on the urban enterprise zone concept.

Let me say at the outset, Mr. Chairman, that I support the concept of urban enterprize zones and believe that if such a proposal were enacted into law that it could be a new and successful tool in the urban workbox. At the same time, let me say that the old adage that "all that glitters is not gold," may aptly describe the enterprize zone legislation, especially if it is seen as end-all of federal programs needed to solve the urban problems that plague our country.

However, I do agree that the enterprise zone concept offers some new hope for our inner cities. The basis of the concept is that by cutting taxes through reductions and credits, the amount of capital invested in cities will increase. The businesses will expand, buy new equipment, and ultimately increase productivity in the enterprise zone. Simply put, the enterprise zone concept uses tax incentives as a means of encouraging new business investments within designated distressed areas.

Should this concept become a reality, such expansion would produce beneficial spin-offs within the designated zone. As a business expands, it would hire new employees, pay more property taxes, and use the services of the local financial and business community to a far greater degree.

Nearly 20 years ago, President Johnson declared a War on Poverty and during these past two decades a litany of programs—Model Cities, Community Development Block Grants, Urban Development Action Grants have come on the scene. I contend that these and other programs have helped hold the line in our central cities. It is within that context that I see the urban enterprise type of program; another useful and possibly important tool.

I am also sensitive to this committee's charge to small business and support you in your concern about how small businesses—which often have low or no profit during their start up years—could take advantage of some of the benefits that might be contained in an urban enterprise measure should it become a reality. It is a tough charge and there are not easy answers.

At least four enterprise zone bills have been introduced in Congress. This bipartisan effort is a recognition of the need to stimulate private investment in areas of serious and continuing unemployment and economic stagnation. During the last presidential campaign and since then, the Reagan Administration has asserted that enactment of enterprise zone legislation is a top priority. I support that priority.

At the same time I believe that the urban enterprise concept must be backed up by programs that help build up infrastructure in our deteriorating inner cities. Such programs as the Urban Development Action Grant, economic development grants and loans are required in order to provide capital. Small businesses can be the prime generator of new jobs, especially in distressed urban areas. Without urban and economic grants and loans such new businesses will not be able to take advantage of the urban enterprise zone concept.

I would also point out that an urban enterprise zone program might be larger than is being proposed. I must admit I was surprised when I look into the matter and found that the Kemp-Garcia bill would designate only 13–25 zones each year.

I perceive the enterprise zone as a tool to be used with other urban and economic development programs. I believe that the significant changes and eliminations being proposed by the Administration in urban programs may make the urban enterprise zone concept even more difficult. The tax cuts for business just enacted into law may also overwhelm the reductions contemplated as incentives for investment in these zones.

There are several specific concerns I have about the Kemp-Garcia enterprise zone bill, some of which I have already mentioned.

The small demonstration program envisioned by the sponsors will hardly generate the national support and excitement which will be necessary to ensure enactment of the bill. A larger program seems highly desirable.

States should not have veto power over the designation of an enterprise zone within a city. The insensitivity of many states to distressed communities may result in few, if any, enterprise zones being designated where they are most needed or could be most effective.

One must be very careful in granting favorable capital gains treatment to businesses which invest in a zone, as such provisions may simply encourage firms to sell out after a number of years.

Linkages should be developed between enterprise zones and other federal programs—EDA, UDAG, job training activities under CETA, and the like.

Mr. Chairman, I would like to commend you on the introduction of your own enterprise zone bill. I am appreciative of your sensitivity to many of the concerns I have raised here as well as to the needs of urban areas and to small businesses. The depreciation incentives in your bill and the tie-in to EDA programs are highly desirable features. I would urge you to consider ways to coordinate enterprise zones with other ongoing federal programs.

Thank you for the opportunity to testify on a subject of great importance and interest to cities and small businesses. I hope the tax committees and the Congress will act soon to formulate a sound and effective enterprise zone bill which will truly spur the development of distressed urban areas.

Mr. NOWAK. Thank you very much, Mr. Landrieu.

When we looked at the spectrum of programs that are out there, it did seem to us, too, that there are many factors that would have to go into a strategy. Much of this has occurred, first of all, with some type of seed money, some type of low-interest loan, especially in the last 1½ years or so, where the rate has been extremely high. And even prior to that happening, some type of infrastructure improvements in the city would have been necessary in order to have the basic industrial area or industrial park to begin with.

I wonder to what extent do you believe the urban action grant or the EDA dollars for industrial parks or low-interest loans has been an element in whatever revitalization has taken place in the small business area in New Orleans?

Mayor LANDRIEU. I think it has been a very important element, and the longer it is in place, the more important a role it is going to play. I am not suggesting that urban development action grants have been the sole cause of revitalization that we are experiencing in most of the downtown areas of America today. That simply would be an overstatement. It, too, is another tool.

I think community development funds have played a great part in that mass transit funds. The psychology, first of all, I guess, that the National Government had an urban policy, that cities and States were concerned. Psychology, I guess, is the thing we have to fight the hardest against. The feeling of abandonment is pervasive, not so much today, but when that feeling widens, the investment community becomes very sensitive to it.

Now, we understand this when we watch the stock market. Every day the stock market responds to what happens in Washington, D.C. Sometimes it doesn't give the response we would like, but nonetheless, it responds. Well, the same thing is true out there of local investors and small businessmen. If the small businessman feels this is an area that has been targeted, that there is a commitment, that it's a long-term commitment, that the help is not only going to be there in the form of promises and on the front end, but it is also going to be there when the times get tough, they are likely to make the investment.

On the other hand, if there is a lack of faith, a lack of trust, a belief that programs will be terminated, that halfway in with his investment he finds the commitment is no longer there, then, of course, the small businessman, and rightfully so, does not want to make that initial step.

Mr. **Nowak**. I am going to yield to Mr. Byron Dorgan, who has a commitment at 11 o'clock, so he may have an opportunity to ask questions. He is someone who has played a very strong role in trying to bring about this whole concept. I would yield at this time to Mr. Dorgan.

Mr. **Dorgan**. Thank you, Mr. Chairman. I have a meeting in the Speaker's office at 11, so I will have to be very quick.

Mr. Secretary, just let me commend you on your statement and indicate that I have followed your career for many years since you were mayor of New Orleans and then a Cabinet Secretary here. I appreciate your statement.

One of the things that interests me is the attempt or the ability that we have to try and measure the efficiency of certain programs. I think you indicated in your statement that the kinds of things we are talking about today in this committee will have to be backed up by continued urban development action grants, economic development grants, and other things.

When we develop these grant programs and implement them over a period of years, I wonder often whether we are able to deal with the efficiency questions of how we are using them. What is your perspective on that issue from your previous service as mayor?

Mayor **Landrieu**. I think it is very, very difficult to measure initially the efficiency of any Federal program. I think, frankly, it takes years and years before we can look back and determine whether or not a program was as effective or as efficient as we thought it would be. That is just the nature of history.

We built a bridge in the city of New Orleans—which has nothing to do with this hearing. We built the bridge 20 years ago and it is the only major bridge across the river there, one of two major bridges. We built a four-lane bridge. It was an incredible success when it first opened. But unfortunately, we underbuilt the bridge and we have found ourselves suffering for the past 10 years with impossible traffic congestion. But it took that 10-year period really to determine whether or not the bridge was built at the proper capacity. Of course, at the time, in all due deference to the planners, they were limited by the amount of bonds that were available and the financial markets, being terribly conservative, said that the bridge would support only these many bonds, because it was a revenue issue.

I think that one of our feelings in Government programs is that we expect too immediate and too great a return on our investment. We try to cut the issue far too close. Every time a program begins to work, there is a horror story about a businessman who made a fortune and therefore didn't need this particular program. Then the tendency is to cut it back.

Well, the fact of the matter is that if you're in the oil and gas business and you're drilling wells, the fact that you hit nine dry holes and on the 10th one you make a killing doesn't mean that you got rich. Now, fortunately, today many people are. But if you don't make it big on that one, you sure are in trouble because you don't find too many people holding your hand on the losers.

The same thing is true in the enterprise zone business and any other venture that we want to start. We ought to hope that out of these programs the small businessman makes money and does well. We shouldn't be concerned that this individual was successful. Surely you're going to have some testing, and there will be some people perhaps who get the help who didn't need it, some zones perhaps that were coming back and didn't need it because they had momentum. But what is the alternative?

We know that to do nothing and to let cities deteriorate because of the Federal policies of interstate systems and housing policies, started 20 and 30 years ago, have caused that deterioration, simply means that very valuable assets lie dormant and, even worse, whole generations living in those areas are lost as a result of it.

It can't only be a Federal designation. I believe very strongly that while all cities have something in common, they are all very, very different. It takes a great deal of local initiative to decide what the history of that city is, what ought to be retained, what shouldn't be retained, and how that city is to develop. And just as apparent, sometimes you have to sit there and think that your child is making a mistake, and give advice and let it happen because that's the way our system works. But there will be many, many more success stories out there than failures if the program is properly structured and is implemented broadly enough.

Mr. DORGAN. I think one of the most disappointing things these days in this town at least is the discussion about Federal spending. The fact is we have done a lot of very good things; we have established a lot of productive and useful programs that are necessary for our inner cities. But the word around this town is that all that spending represents some sort of liberal do-gooder approach to Government.

I think the point you make is that it takes a great deal of patience and a great deal of cautious investment and careful construction of programs that are directed to provide the kind of incentive that is needed.

Again, I think we have done a lot of very good things in this country, and I am concerned about the efficiency of what we do because I think while we put in place programs to accomplish certain goals, we have to at the same time measure their effectiveness and their efficiency.

You may have a different opinion on this, but in my judgment probably one of the most wasteful public programs this country has ever seen was the LEAA, the Law Enforcement Assistance Act, and that happened to be a block grant program in this country. In my opinion, in watching it work from a local level, I thought it was probably one of the most colossal wastes of money that we have ever seen. So I think we have a responsibility to work with local government to do what we are talking about today, using the private sector and incentives and stimulus, and at the same time to maintain a public sector responsibility through a series of programs that are carefully directed to deal with the problems that you perceive and that I perceive in the State and local governments.

I am going to be late for my meeting. Again, Secretary Landrieu, I appreciate your testimony.

Mr. Chairman, thank you for yielding. I appreciate it.

Mayor LANDRIEU. Thank you, sir.

Mr. NOWAK. Thank you very much, Mr. Dorgan.

At the time you were the Secretary of HUD, before we passed the latest round of cuts, this concept of enterprise zones, a pure and simple form of increased tax incentives, was starting to be discussed.

I wonder if the Agency ever got involved in it at that time or any direction was given to the Agency to look at this and what were the results.

Mayor LANDRIEU. I believe we did a paper, a policy planning unit on it. Congressman Garcia, a great friend, was very much interested in it. I think that we viewed it very much the same as I am testifying today. I am certainly not testifying on behalf of the past administration or on behalf of anyone at HUD. It is personal testimony. My view has not changed.

It can be a useful tool, provided there are other tools to work with it. It is simply, in my judgment, not enough to suggest that by creating a zone and giving tax incentives that there is going to be a great rush of small businesses into that area. That has not been the case. Local governments have not sat idly by. There are a number of incentives which local governments have given—tax increment financing, the abatement of taxes; in some instances, free land. All of those things help a little bit. But I dare say that it becomes quite obvious that to go into a riot-torn area—and I am not trying to suggest that is a problem today—but if you took the riot-torn area in Washington, D.C. in the late sixties, very early seventies, all the incentives in the world from a bill such as this would not encourage a business to locate there. It is just a function of our economic system.

We ought to play to the strength of the system. I guess if you're an athlete and—you know, there's a theory about playing to your strength. You do that which you know how to do well. That is true also in election politics. So we ought to be working with those areas that are coming back, helping those.

At the same time we should not be ignoring those areas that are terribly depressed. But we make a great mistake if we believe that this program will work equally in both areas. It will not. It will help encourage redevelopment where there is some momentum going. I am not so certain that it is enough to start where there is a very depressed area.

Mr. **Nowak**. In the last couple of months there has been a renewed interest in something called the Federal deficit, especially the people on Wall Street who have certainly shown some discomfort with the projections that have been made. I guess there are two ways you can put incentives to work—the direct, so-called overt incentives that have been used in the sixties and early seventies. They have been criticized, of course, because it is Federal spending and it creates deficits.

On the other hand, you can create deficits another way by reducing revenues through tax incentives, and you end up at the bottom line of some revenue loss and therefore you increase your deficit on the other end. So if the overt programs are going to be reduced and we don't have a combination and totally rely on the tax code, that brings up the other problems of trying to broaden or round out a successful urban policy.

I wondered if you would comment on the revenue loss that some have talked about, in relation to, if the tax incentives go in, how much revenue loss is there, how much can we sustain, and do we have a greater so-called return for that type of revenue loss than we have for the direct overt spending.

Mayor **Landrieu**. I guess I can best address the question this way, Mr. Chairman. At least on the expenditure side there is the opportunity, at least a more direct opportunity, for the Federal Government to direct its policies than the Federal Government has by not collecting the tax to begin with. I'm not for taxing and spending. I don't necessarily believe in that system. But it is true that the Federal Government has certain responsibilities and the only way those responsibilities can be discharged is through taxation and spending of those dollars. Whether that is in transportation, land transportation or airports, clean water, whatever have you. And as the national conscience changes, is elevated, as the national agenda changes, then the Federal system has to respond.

You cannot do it only through tax incentives. It takes some Federal dollars. The reason is, we are not all starting from the same place. We are not starting from scratch. I don't think anyone can seriously argue that the suburbs would have been built to the extent that they are today had it not been for enormous outlays in the form of highways and in subsidies and lending policies, FHA loans and VA loans. I think that should be evident to anyone.

Now, having put all of that in place, what do you do about the places that have now been abandoned and have deteriorated as a result of it? There isn't any earthly way that a small downtown retail area can compete with a clean piece of ground, the roads to which have been built by the Federal Government or the State government, the sewer system placed in, all the infrastructure placed in, and built to accommodate modern day shopping to a scale that is profitable.

Now, if we have done that to assist that area, then is it any less fair to say, "Well, what about the people who are left in this abandoned area here?" I understand it takes money, and I am not suggesting the Federal Government can cure all the ills. But I think it is grossly unfair to expect local inner cities to be able to cure that ill all by themselves when the Federal Government and in many instances State governments also contributed to the deterioration that we are now fighting.

Mr. **Nowak**. Rick Centner, who is counsel for the minority, has some questions.

Mr. **Centner**. Part of the reason for that question, Mr. Mayor, was your testimony that you thought 15 to 25 urban enterprise zones was too small a number. First of all, we don't know that they will work. Second, if they do work, there is some revenue loss in terms of the tax incentives offered in the zones; and, as you have testified, many of the proponents of the urban enterprise zones think there should be additional, direct Federal subsidies to these cities.

My question is: Isn't it possible the 15 to 25 number is not simply an arbitrary number but is based on the expectation of the expense involved in establishing enterprise zones and the lack of certitude that they will work? Should we try to avoid the kind of thing that we did with the swine flu vaccine where we went out and vaccinated the whole country and then ended up with people dying?

In other words, shouldn't we try it out and also see if we can cut our losses before we make a complete commitment?

Mayor **Landrieu**. Well, I have no quarrel whatsoever with it as a demonstration program. You know, we have consistently, when putting new programs into effect, done it on a demonstration basis. So if you want to try it with 15, 20, or 30 cities, going in and seeing whether it works, I think that's a perfectly acceptable approach to the world. I think it is very real.

But we should also know that if it does work you have got to do something with it; otherwise, the experiment will have been useless. It will have been an academic exercise. Because 15 to 20 zones a year won't even begin to scratch the surface. It's far better perhaps not to have even tried it, because again you build up false hopes if there is nothing to follow, if there's not another that you're going to drop.

Mr. **Centner**. Thank you, Mr. Chairman.

Mr. **Nowak**. Charles Roemer is from Louisiana and I would assume he has heard of our witness and vice versa, so I will——

Mr. **Roemer**. I have, and thank you, Mr. Chairman.

I guess I want to say two things initially, Moon, if I could. First I apologize for being late. As you know, around here time is the most precious commodity and I ran out of it this morning.

Second of all, I just want for the record, Mr. Chairman, to say that Mr. Landrieu does come from Louisiana and represents the very best in Louisiana politics and Louisiana urban affairs. His reputation goes deep in our State.

I come from a more rural area of the State than does Mr. Landrieu, but his city is the gemstone of our State and in large part though his efforts as mayor there for a number of years. I don't know how many years you were mayor, 15, 25 or 30——

Mayor **Landrieu**. It seemed like forever.

Mr. **Roemer**. I understand. [Laughter.]

But I did have a couple of questions about your prepared statement, Mr. Landrieu, if I could. First of all, did you say in my absence—and if you did, just repeat it quickly. Do you think that

New Orleans, from your perspective, would take advantage of these kind of enterprise zones?

Mayor LANDRIEU. Yes; I do.

Mr. ROEMER. Do you think they would try to be first on the list and really get after this?

Mayor LANDRIEU. I would think so.

Mr. ROEMER. Obviously, with that statement, do you think it would accrue tremendous benefit to the development of small business and jobs in the New Orleans area?

Mayor LANDRIEU. No; I do not.

Mr. ROEMER. You do not?

Mayor LANDRIEU. No, sir.

Mr. ROEMER. You don't think that this program in and of itself will really make much difference in job creation in New Orleans?

Mayor LANDRIEU. No, sir, I do not.

Mr. ROEMER. You do not?

Mayor LANDRIEU. I do not.

Mr. ROEMER. Do you then think the Government ought to spend the kind of money that we're talking about for job creation in these enterprise zones if, in fact, it won't make any difference?

Mayor LANDRIEU. Well, it is very difficult, Mr. Roemer, to attack the urban problem or even the argument in a piecemeal fashion. I think you have to approach in a much broader context, and that is what is the Government's agenda, what does the Government want to do about cities, what does it want to do about poverty, what does it want to do about underemployment and lack of education.

Now, I full well understand the sentiment of the country today, and that is that we have been spending more money than we have and therefore we are going to stop spending that which we don't have. That I certainly understand. It doesn't do much, however, to cure the problem out there. You still have the problem.

Now, it may be that living with the problem is better than creating another problem of greater deficits. That is what you're having to wrestle with. But I think it is unrealistic to believe that when we reduce government spending and you cut out community development and general revenue sharing, God forbid, the training programs, the poverty programs and all of what else is out there, that as a result of supply side economics all of a sudden these neighborhoods are going to blossom—I mean, we have almost convinced ourselves that these programs have caused the problem. I can assure you, having worked in the city for 20 years, that that is not the case.

I don't say that because we have in some instances have been overly generous, that because we haven't governed programs, social programs, carefully enough, that we have developed some dependency, social dependency on those programs. I think that is quite true. But I do not believe it is true with respect to cities themselves, structurally. I know of very few cities that have simply said, "There is Federal money there and we're not going to raise it ourselves." Cities don't have the capacity to raise money.

When I was a kid we used to pick up garbage five times a week. We're picking garbage up twice a week now. It isn't that the city services have improved. City services across the board, except in a few terribly healthy cities, have deteriorated very badly.

There was a time in your neighborhood and my neighborhood you could safely walk out of your front door and go visit your neighbors. Today, you don't dare do that after dark. So we can look at any number of areas where the services have deteriorated and the quality of life has deteriorated in cities.

Oddly enough, I don't think that is true across the board. There are neighborhoods which, when you and I were younger, were deteriorated that have come back and have been rehabilitated. You see examples of this all over Washington, D.C. But there are also areas that were very thriving areas when you and I were younger that today have deteriorated. So cities tend to move in cycles. Neighborhoods improve and decline.

Now, do we want to let that take its normal course? Or do we want to try to intervene in order to assist? That's what enterprise zones does, and it's a good concept. But it is only one tool in the urban workbox.

Mr. ROEMER. Then would you agree with the statement, after listening to you talk, that the role for these enterprise zones is clear in your mind; however, they are not a substitute for programs currently on the books; they have to be in addition to, that they are only one tool in that——

Mayor LANDRIEU. Yes, and I don't mean to say that you shouldn't cull out, that you shouldn't reanalyze what tools are available and perhaps as you add this one modify others or eliminate one or two others. You just can't——

Mr. ROEMER. Could I interrupt you right there? Could you give us an example, in your experience as a mayor and as a Secretary in the Cabinet, and your variety of experiences, as to the kind of programs we might cull out?

Mayor LANDRIEU. Well, I wasn't called here today to do that, but I would be very happy at some occasion to tell you programs that I think have been terribly effective and others that haven't been.

Mr. NOWAK. Just on that point, perhaps you could give that question some thought because we really are trying to bring together the best of what exists and perhaps new modifications of those programs, and we would like to keep the record open until you would have the opportunity to go through all of those tools that Mr. Roemer talked about. We would be happy to have that testimony at your convenience.

Mayor LANDRIEU. I thank you, Mr. Chairman.

Mr. ROEMER. That would be a big help, Mr. Landrieu, if you could. Because you are absolutely correct in saying that we have got some tough decisions to make and there is a growing feeling in this Congress and perhaps in this country that the money expended in excess of the money brought in, the deficit in other words, many of which moneys went to fund these kinds of programs, might have done more damage than the good brought about by the programs themselves.

You can carry that to any number of extremes, and I am not saying that's an absolute fact. But if we can find some ways to pare down, cut back, in programs that do not work, and put our precious dollars in programs that do, we might all be better off.

Mayor LANDRIEU. Well, I certainly agree with you that this Government, like any individual, cannot indefinitely spend more money than it takes in. I think that is self evident. But I do think we have to make some distinctions. It has always troubled me a little bit that we don't make a distinction between capital outlays and operating outlays. The State of Louisiana constantly borrows money for bonding purposes, and so do city governments and so do individuals as we buy our homes. The difference is that we pay those back, and we pay them back out of current revenues. We try not to borrow, at least not for the long term, for operating purposes. Unfortunately, the Federal Government has gotten into that posture. That obviously has to be corrected.

The only issue that I would take with you, Buddy, is that it depends upon whose dollar is being spent. You know, like the kid walking to the church flipping two nickels and dropped one and it went down the drain. He said, "Gee, God, I'm sorry I lost your nickel." Well, I don't know why it is always assumed that the dollars spent on the urban programs were the ones causing the deficits. I don't know why it wasn't the ones spent on highways or on dams or on a multitude of other things. But inevitably the argument is made that it is these programs that are causing the deficits. Let me assure you they are the smallest of the Government programs. I'm not talking about HEW. It's a gigantic department. But if you looked at the expenditures we have spent in the cities, they are miniscule in comparison to the other parts of the Federal budget. The problem is we were the last one aboard, and because we were the last one aboard, whenever there are cutbacks, you look for the last guy that got on. Actually, you ought to tell that fellow to move up to the front a little bit, "You've been out of the game too long." But the tendency is to push the last dollar off. That is one of the issues that we certainly feel needs to be addressed.

Mr. ROEMER. Well, I am out of time. Let me just conclude by saying thanks for coming once again, and urging you to give a review—I know you don't have much spare time, but it would be a help to this subcommittee I know if you would give a review of those programs which you have first hand knowledge of and kind of give us a ranking.

Let me say personally, Mr. Landrieu, that we are not picking on urban programs. I mean, we're going to have to look at every program, urban included.

Mayor LANDRIEU. Mr. Roemer, let me say I am practicing law and I do not have a staff of researchers. I will try to assist this subcommittee where I can, but I hope that you relieve me from the responsibility of researching all of the programs—I know that you're not asking this, but I wanted to make it straight for the record—and responding to this subcommittee in a very lengthy document.

There is a policy statement that President Carter issued, and I mention the name not to be partisan but I think it may be a good reference document for this subcommittee, which takes a look at where cities were 10 years ago and where they are today, and which programs we felt at that time were working. It was issued as part of the urban policy statement and it's a fairly good reference work. I think that would be a good starting point for you.

Mr. ROEMER. Very good. Thank you.

Thank you, Mr. Chairman.

Mr. NOWAK. Thank you very much. Again, Mr. Secretary, we would like to thank you for coming and sharing your thoughts with us. What we are trying to do, of course, is complement the recent tax changes as they have occurred, and if we can do that with a broad urban policy that makes sense and makes better use of those limited dollars, perhaps we can make some inroads.

Thank you very much. We appreciate your time.

Mayor LANDRIEU. Thank you, Mr. Chairman.

PANEL CONSISTING OF DAVID HASH, DAVID SLOANE, AND G. CHESTON CAREY

Mr. NOWAK. Our next set of witnesses will be from the National Association of Wholesalers-Distributors and also, in combination with that, the Baltimore Economic Development Corp.

We have with us from the Baltimore Economic Development Corporation Mr. David O. Hash, who is senior vice president in charge of land development and areawide improvement program. He has been involved in planning and development work since his graduation from Virginia Tech, where he had an education in architecture, planning, and environmental studies.

From the National Association of Wholesaler-Distributors is Mr. G. Cheston Carey, who is president of Carey Machinery and Supply Co., Inc., and a member of the Enterprise Zone Subcommittee of Greater Baltimore Development, and also we have Mr. David Sloane, who is director of congressional relations with us today. So, gentlemen, we can proceed with Mr. Hash, and then we will take the testimony of the National Association of Wholesaler-Distributors.

TESTIMONY OF DAVID O. HASH, SENIOR VICE PRESIDENT, BALTIMORE ECONOMIC DEVELOPMENT CORP.

Mr. HASH. Thank you, Mr. Chairman. My name is Dave Hash and I am senior vice president of the Baltimore Economic Development Corp., which is a quasi-public, nonprofit corporation established by Mayor William Donald Schaefer and the city council of Baltimore back in 1976. Our job is to create job opportunities for the city of Baltimore and try to expand its economic base. We have a number of programs and projects that we are undertaking to achieve that objective.

On behalf of Mayor Schaefer, who unfortunately could not attend today's hearing, I would like to read a relatively short statement that the mayor asked me to read before the committee, and if you will bear with me for a couple of minutes I would like to go through that statement and then we can get into questions.

The issues of job creation and urban revitalization, where unemployment and disinvestment continue to plague our industrial base in Baltimore, are extremely important. While we have had many successes in economic development by taking good ideas and turning them into workable programs and projects, and going after creative financing, we are concerned that our ability to deal effectively with our long-term economic problems not be weakened.

As you are obviously aware, the Reagan administration is attempting to bring inflation under control, to stimulate private investment, to increase productivity, to enhance the competitive posture of American industry, and to increase employment opportunities. We in Baltimore strongly support these goals and would like to elaborate on our views about the best ways to achieve them. Before doing so, however, let me spend just a few minutes talking about some of our existing approaches to job creation and urban revitalization, because I think they will demonstrate that we have been trying to do much that is suggested, particularly by such newly proposed programs set forth in recently introduced enterprise zone legislation.

Our efforts began in earnest during the late fifties and early sixties with the Charles Center development project. This was the first time that a large area within the center city had been cleared and redeveloped with public and private resources, and in a coordinated and comprehensively designed fashion. While the area was once characterized by urban decay, today it gleams with new offices, retail shops, recreational opportunities, and people places, which we feel are very important. The essence of its success, however, is not just the buildings, not just the physical structures of downtown, but the jobs and the increased tax dollars which were created in a concentrated area. These tax dollars have helped us provide much needed services to all parts of the city.

Our success in Charles Center has been followed by the even more dramatic transformations in our Inner Harbor, and also the revitalization and new feeling of pride in our neighborhoods and other economic development projects involving our business community directly. Indeed, through the efforts of the Baltimore Economic Development Corp., and with the help of Federal agencies such as the Economic Development Administration and programs such as the urban development action grant program, in 1980 alone we created or retained over 6,000 industrial jobs and considerable tax dollars. We readily admit that we could not have done this without the partnership and support of the Federal and State government and, of course, the private sector.

What is the relevance of this history to our task at hand, addressing the future needs of job creation and urban revitalization? Well, quite simply, it demonstrates that the focused approach to stimulating private investment is needed and can work if properly designed and administered, pooling resources available for site assembly, infrastructure, financing, and support services. In general, this is the essence of what we are doing in Baltimore today. But let me be a bit more specific by outlining some suggestions about how to approach these challenges.

First, the enterprise zone concept that has received a great deal of attention in recent months is supported by Baltimore, and we believe that the tax incentives contained in pending legislation offer a good starting point for formulating a comprehensive economic development package. We think there are many good elements in each of the four enterprise zone bills in Congress, and let me highlight several of them here.

The 50-percent reduction of income taxes on business income earned within the zone is a strong incentive for the location and expansion of profitable firms and their branches. The elimination of the capital gains tax for taxpayers within the zone, for example, is a good idea and should remain a key provision. And the tax credits for employers and employees are very important.

Moreover, the reduction of certain Federal reporting and regulatory requirements and coordination of all Federal assistance for zone activities are quite welcomed. However, to be truly effective, the accelerated depreciation suggested in earlier versions of the legislation should be reinserted. This will encourage medium sized firms such as branch plants to locate in zones. Without the benefit of accelerated depreciation, these firms will most likely build or invest in surburban locations. There must be a differential advantage for the enterprise zone over the recently enacted accelerated cost recovery provisions generally available now through the new tax bill.

Second, we must not make the mistake of assuming that the enterprise zone legislation alone constitutes an entire program for economic development for distressed cities. Indeed, it does not. The tax incentives in this legislation should be viewed as a foundation for a much larger package of business incentives. The Economic Development Administration or similar programs operated by HUD, for example, must be available to help finance new road and utility construction to make urban development areas competitive.

Likewise, the urban development action grant program should be continued to help cities leverage the startup and expansion capital so important to business development. And training programs must be available to prepare a work force to meet the expanded demand for skilled workers. While the things that these programs do are often taken for granted, think of how hard it would be to locate a business, create jobs, and revitalize distressed cities such as Baltimore without them. Indeed, it is unrealistic to assume that we can achieve our goals without a balanced set of incentives.

Let me give you an example of what I mean. In Baltimore, we are developing a 40-acre industrial park called Park Circle, in a low-income minority neighborhood known as Park Heights. The unemployment rate in this area is over 18 percent overall and over 50 percent for youths. The goal of the project is to create over 1,700 jobs, targeted primarily to neighborhood residents. We are working with the neighborhood leaders and the private sector, and we are using CETA funds to train workers and we are using EDA funds to prepare the sites.

We are also making our own commitment and using local funds and State funds to implement this project. Without these resources, companies like Control Data and Commercial Credit, which have made a commitment to locate at the park, would be unwilling to do so. They are not in the business of building their own roads and training their employees, especially if the new employees are the hardcore unemployed. Indeed, without the provision of these essential services, suburban locations become the preferred alternative. Thus, funds must remain available for land acquisition, site preparation, and manpower training.

Third, there is a strong need for financing for both small and large firms as well as new and existing business. According to a recent study from MIT, most of the new jobs in this country come from small business creation and expansion. We have found this to be true in Baltimore. Yet it is usually difficult for small businessmen to find the venture and working capital that is needed to begin a business and to create jobs. In this regard, the direct loan and loan guarantee programs of the SBA and EDA should not only be maintained but expanded and coordinated with the enterprise zone program.

Fourth, much attention has been focused lately on industrial development revenue bonds. We have used revenue bonds in Baltimore very selectively to attract investment in our renewal areas and to generate new job opportunities. One way in which Congress could assist distressed cities such as Baltimore and projects like the Park Heights, Park Circle Industrial Park projects, is to limit the use of revenue bonds to such depressed cities and geographic areas. That in and of itself would provide a major financial incentive for investment in inner cities, and would be entirely consistent with the targeted approach espoused by the enterprise zone legislation.

Finally, we must continue to emphasize the importance of partnerships which have been forged in the past. As I noted earlier, we would not have been as successful in Baltimore without the active participation of all levels of government as well as the private sector. We have recently formed a new group in Baltimore known as Blue Chip-In, where we are asking businesses to contribute funds to worthy, jobs-producing community projects that have suffered due to recent budget cuts. However, what we already know is that neither the public sector nor the private sector alone can bring about sustained economic recovery in today's urban environment.

If we are to revitalize our cities and create jobs, we must do it in close cooperation with the Federal, State, and local governments, and of course the private sector, and to take full advantage of all the resources that are in place, and develop new ones, like enterprise zones, to maximize their impact.

In closing, on behalf of Mayor Schaefer, let me thank you for the opportunity to address you on these issues, and let me invite you to visit Baltimore, which is only an hour away. Congressman Kemp visited us not long ago and we would welcome the opportunity to show members of the committee how we have put your programs to work.

Just in summary, what the mayor is saying is that targeted incentives are important, and we feel the enterprise zone would provide a vehicle to do that. What we would like to see is greater tax benefits built into the legislation, including accelerated depreciation.

As Mr. Landrieu said, grants for infrastructure, roads, utilities, et cetera are essential. Financing is essential. Firms, particularly startup firms, just do not have the access to capital. Without that access, without somebody stepping up to take the risk, we are talking about a very difficult time in making these zones work. Also, recruitment and training programs are very important and all of these things need to be tied in into a target arrangement in order for the zones to work.

Thank you.

Mr. Nowak. Thank you very much, Mr. Hash.

We would now like to hear from the National Association of Wholesaler-Distributors, and I will now call on David Sloane, who is director of congressional relations.

TESTIMONY OF DAVID SLOANE, DIRECTOR OF CONGRESSIONAL RELATIONS, NATIONAL ASSOCIATION OF WHOLESALER-DISTRIBUTORS, ACCOMPANIED BY G. CHESTON CAREY, PRESIDENT, CAREY MACHINERY & SUPPLY CO., INC.

Mr. **Sloane**. Thank you very much, Chairman Nowak, Congressman Roemer, and subcommittee staff.

I am, as you said, director of congressional relations for the National Association of Wholesaler-Distributors. Appearing with me this morning is Mr. Cheston Carey, Jr., president of Carey Machinery & Supply Co., Inc., Baltimore, Md. Mr. Carey's firm is a member of NAW and also a member of two of NAW's affiliate associations, the National & Southern Industrial Distributors Association, and the Safety Equipment Distributors Association.

We are delighted to appear before the subcommittee this morning to discuss the critical issue of urban revitalization and job creation. For purposes of expedience, we will summarize our remarks and would ask the full body of our testimony be incorporated into the hearing record.

Mr. **Nowak**. Without objection, so ordered.

Mr. **Sloane**. Thank you.

The National Association of Wholesaler-Distributors is a federation of 121 national commodity line trade associations which have an aggregate membership of approximately 50,000 firms, with 125,000 business locations. Our members are responsible for approximately 60 percent of the $1 trillion of merchandise which will flow through wholesale channels this year, according to the Department of Commerce. While our members are generally small to medium-sized, closely-held firms, their collective economic importance is great.

[List of 121 national commodity line trade associations follows:]

National Wholesaler-Distributor Organizations
Affiliated with the National Association of Wholesaler-Distributors

Air-conditioning & Refrigeration Wholesalers
American Dental Trade Association
American Jewelry Distributors Association
American Machine Tool Distributors' Association
American Supply Association
American Surgical Trade Association
American Traffic Services Association
American Veterinary Distributors Association
Appliance Parts Distributors Association, Inc.
Associated Equipment Distributors
Association of Footwear Distributors
Association of Steel Distributors
Automotive Service Industry Association
Aviation Distributors & Manufacturers Association

Bearing Specialists Association
Beauty & Barber Supply Institute, Inc.
Bicycle Wholesale Distributors Association, Inc.
Biscuit & Cracker Distributors Association

Ceramic Tile Distributors Association
Ceramics Distributors of America
Cooperative Food Distributors of America
Copper & Brass Servicenter Association
Council for Periodical Distributors Association
Council of Wholesale-Distributors
  American Institute of Kitchen Dealers

Distributors Council, Inc.
Door & Hardware Institute
Drug Wholesalers Association

Electrical-Electronics Materials Distributors Assn.
Explosive Distributors Association, Inc.

Farm Equipment Wholesalers Association
Flat Glass Marketing Association
Fluid Power Distributors Association, Inc.
Food Industries Suppliers Association
Foodservice Equipment Distributors Association
Foodservice Organization of Distributors

General Merchandise Distributors Council

Hobby Industry Association

International Ceramic Association
The Irrigation Association
Institutional & Service Textile Distributors Association, Inc.

Laundry & Cleaners Allied Trades Association

Machinery Dealers National Association
Mass Merchandising Distributors Association
Material Handling Equipment Distribution Association
Monument Builders of North America-Wholesale Div.
Motorcycle Industry Council
Music Distributors Association

National-American Wholesale Grocers' Association
National Appliance Parts Suppliers Association
National Association of Aluminum Distributors
National Association of Brick Distributors
National Association of Chemical Distributors
National Association of Container Distributors
National Association of Decorative Fabric Distributors
National Association of Electrical Distributors
National Association of Fire Equipment Distributors
National Association of Floor Covering Distributors
National Association of Manufacturing Opticians
National Association of Marine Services, Inc.
National Association of Meat Purveyors
National Association of Plastics Distributors
National Association of Recording Merchandisers, Inc.
National Association of Service Merchandising
National Association of Sporting Goods Wholesalers
National Association of Textile & Apparel Distributors
National Association of Tobacco Distributors
National Association of Writing Instrument Distributors
National Beer Wholesalers Association
National Building Material Distributors Association
National Business Forms Association
National Candy Wholesalers Association
National Commercial Refrigeration Sales Association
National Electronic Distributors Association
National Fastener Distributors Association
National Food Distributors Association
National Frozen Food Association
National Independent Bank Equipment Suppliers Assn.
National Industrial Belting Association
National Industrial Glove Distributors Association
National Lawn & Garden Distributors Association
National Locksmiths' Suppliers Association
National Marine Distributors Association
National Paint Distributors, Inc.
National Paper Trade Association, Inc.
National Plastercraft Association
National Sash & Door Jobbers Association
National School Supply & Equipment Association
National & Southern Industrial Distributors Associations
National Spa and Pool Institute
National Truck Equipment Association
National Welding Supply Association
National Wheel & Rim Association
National Wholesale Druggists' Association
National Wholesale Furniture Association
National Wholesale Hardware Association
Northamerican Heating & Airconditioning Wholesalers
North American Wholesale Lumber Association, Inc.

Optical Laboratories Association

Pet Industry Distributors Association
Petroleum Equipment Institute
Power Transmission Distributors Association, Inc.

Safety Equipment Distributors Association, Inc.
Scaffold Industry Association
Shoe Service Institute of America
Specialty Tools & Fasteners Distributors Association
Steel Service Center Institute

Toy Wholesalers' Association of America

United Pesticide Formulators & Distributors Association

Wallcovering Distributors Association
Warehouse Distributors Association for
  Leisure & Mobile Products
Watch Materials & Jewelry Distributors Association
Water and Sewer Distributors Association
Wholesale Florists & Florist Suppliers of America
Wholesale Stationers' Association
Wine & Spirits Wholesalers of America, Inc.
Wood Heating Alliance
Woodworking Machinery Distributors Association

Mr. **Sloane**. A little bit about the industry. Of the 238,000 merchant wholesaler-distributor corporations filing tax returns in 1977, 99 percent had assets of $10 million or less. These smaller firms accounted for about 58 percent of the industry's sales volume. In contrast, in the manufacturing sector, approximately 2 percent of the firms controlled about 88 percent of the assets and accounted for approximately 80 percent of the sales. The wholesale distribution industry provides in excess of 5¼ million jobs with average hourly wages of $6.87.

We do have a substantial interest in targeted areas. While the association has not yet developed a position on enterprise zone or job expansion legislation, wholesaler-distributors, by virtue of their position in the marketing chain, are concerned and have a vested stake in the economic well-being of urban America.

The association believes that wholesaler-distributors can play a vital role in targeted urban revitalization areas by assisting small business entrepreneurs in a variety of beneficial ways. In addition to inventorying, selling, and delivering goods to all manner of business users, wholesaler-distributors also provide other valuable services. They help their customers identify new markets, products and related strategies, identify proper stocks and quantities of merchandise, extend credit, and take risks with new businesses, and provide valuable financial and other advice. In short, the wholesaler-distributor has a vital interest in the survival and prosperity of his customers.

Moreover, the wholesaler-distributor provides important connections between manufacturers and business customers. According to an NAW survey, the typical wholesaler-distributor establishes market connections between 133 manufacturers and 533 business customers. Therefore, business customers are assured of optimum competition and pricing of needed products and services, and availability of those products at the place and time of need.

The association looks forward to working with this subcommittee in forging legislation that will assist small business entrepreneurs in succeeding in targeted areas, and in promoting job expansion.

Mr. Carey is uniquely qualified to discuss the issue of urban revitalization. As former chairman of the Baltimore Council for Equal Business Opportunities, he has had extensive experience in counseling and advising small minority owned businesses. The council assists businesses in packaging, promoting, and securing financial assistance from various commercial and governmental sources.

Additionally, Mr. Carey is a member of the Greater Baltimore Committee, a business organization comprised of over 800 Baltimore area firms which recently merged with the Baltimore Chamber of Commerce. He served as a wholesaler-distributor representative on the Greater Baltimore Committee's Enterprise Zone Subcommittee, which concluded in July of this year a study of the enterprise zone concept and its applicability to Baltimore.

With that, I would like to turn it over to Mr. Carey.

Mr. **Carey**. Good morning, Mr. Chairman, and Congressman Roemer, members of the subcommittee staff. I am, as introduced, Cheston Carey, Jr., and I am president of Carey Machinery & Supply Co., Inc., of Baltimore, Md. Carey Machinery is an industrial supply house which sells a broad array of products to industry, including pumps, compressors, power transmission equipment, grinding tools, cutting tools, and so on. The firm has been in operation in Baltimore since 1887.

Before I address this morning's topic I would like to take a moment to thank the chairman and also the ranking minority member for their interest in the area of capital retention and inventory valuation in the wholesaler-distributor industry, as evidenced by your sponsorship of the Inventory Simplification and Reform Act of 1981. I think it is H.R. 2319. This is a vital issue to wholesaler-distributors.

Second, before I get into my prepared remarks, I have sat here and I have heard New Orleans at the top of the list and then moved down to second, behind Buffalo. I am sure if Mayor Schaefer were here, with his inimitable and unique enthusiasm for Baltimore and what it has done, he would be fighting for the No. 1 spot. But we certainly, as Dave has indicated, have a lot of things in place already that we feel are responsive to the whole idea of targeted help from the Federal Government in the inner cities.

As an urban entrepreneur with substantial experience in small and minority business startups, I believe that small business entrepreneurs can make a significant contribution to urban revitalization. However, let me concur with previous witnesses, that the current Federal legislation targeting distressed areas is not a panacea to decades of urban deterioration. There are no easy solutions to this awesome problem.

While such legislation must, I believe, be implemented as soon as possible, the establishment of job expansion areas or enterprise zones should at first be approached on an experimental basis only. Through experimentation in several well-chosen locations, policymakers will begin to develop the proper mix of inducements and incentives for a successful program of broad design and application.

Flexibility will be an essential ingredient as Federal, State and local officials fashion programs that respond to disparate urban conditions. Factors such as regional and/or local economic problems, or geographic circumstances, will undoubtedly play a part in the establishment of targeted areas. Congress should not seek to establish an ironclad framework for the creation of these areas at this early juncture. Instead, legislation that permits and encourages flexibility in meeting local conditions is a much more prudent and cost-effective approach.

My primary objective today is to provide this subcommittee with some of the salient insights and practical concerns of the Greater Baltimore Committee which studied this question of enterprise zone formation. As a small business participant on the GBC, and as an individual with considerable background in business development, I think I can provide you with some valuable thoughts. I am not here as a spokesman for the GBC, nor do I speak in any other official capacity.

Additionally, Mr. Chairman, I do not intend to comment specifically on your bill, the Enterprise Development Act of 1981, H.R. 2965, or upon the contents of any of the other current Federal bills in this subject area. However, I will say upon my own reading that your bill may be more helpful to small business startups than some of the others.

I view this hearing as part of the discovery phase of policymaking and, as such, will be making general remarks on the kinds of concerns I have witnessed in Baltimore.

NAW, as David has already indicated, is also in the discovery phase and has not yet developed a specific policy with regard to current legislation. However, we are committed to urban revitalization and have a vested interest in the continuation and health of urban economies. We look forward to working with the subcommittee.

The GBC enterprise zone subcommittee started with the fundamental assumption that job creation was the paramount objective of the legislation, and that other related goals would be achieved as a byproduct of reemployment. Consistent with that objective was our conviction that small business is the primary vehicle for job creation and retention in this country today. Therefore, we knew that small business startups would be the key to maximizing the job creation potential of these targeted areas.

Yet, as was reiterated time and again by the small business people who came before us—and as you have heard earlier today and perhaps yesterday—tax incentives alone are not enough to stimulate or attract small business startups. The new business is not yet earning taxable profits, as is true in most cases, and capital gains or income tax relief simply is not an effective or useful incentive. Instead, small business representatives repeatedly talked to us about incentives like inexpensive or free seed capital, inexpensive labor and property, service amenities and facilities, and relief from Federal, State and local redtape.

The general unavailability of cheap seed capital will be a major obstacle to small business startups in targeted areas. While Federal funds have been available from SBA and other sources, these moneys have been administratively onerous to access, and scarce.

Additionally, with the tremendous pressures to further reduce Federal spending and to balance future budgets, these funds are becoming all but nonexistent. There are no easy solutions here, but creativity is clearly needed to develop new sources of seed capital. Venture capital, traditional bank loans and other forms of commercial credit will not fully satisfy this need in our judgment.

Tax incentives are important for the larger businesses which might be attracted to distressed areas, given the proper inducements. The GBC subcommittee felt that larger businesses could and should serve as an anchor in targeted areas, attracting the investments of other satellite smaller concerns. As Dave has already mentioned, we have a lot going in the area in Baltimore known as Park Heights, where C. & P. Telephone and City Venture Corp., which is a Control Data affiliate, have made substantial investments. City Venture is developing a business and technology center to provide low rents, counseling, typing, and other support services to small business.

Parameters need to be set for the selection of large businesses eligible for participation in targeted areas. An influx of too many would stifle small business growth and development and limit the job-creation potential of such areas. Moreover, large businesses would have to be establishing new plants and facilities, not just relocating existing ones.

I think there is enough that has been said about the need for the infrastructure and the various improvements that need to be made in these enterprise zones. In Baltimore and many other areas, much of this important work has been accomplished through the urban development action grants and the EDA projects, and Baltimore has benefited tremendously from these sources. However, with the current deemphasis on Federal spending and the budget-cutting in Washington, these funds are beginning to dry up. This problem is somewhat less critical for targeted areas with strong local support, as in the case of Baltimore. However, the budget problems in Washington are fast becoming the problems of State and local governments.

We would put in a strong concurrence here that the kinds of programs we have been talking about that seem to be on the wane will continue to be important in enterprise zones or targeted areas in the future.

Also along these lines, from my own past experience as chairman of the Baltimore Council for Equal Business Opportunities, I believe that a wide range of business counseling services, day care and drug rehabilitation, job counseling and other professional training and social support services will be necessary to insure successful and stable reemployment in these areas. All these community services cost money, but the success of targeted area programs is in our judgment dependent upon their provision.

Flexibility must be permitted in the designation of targeted areas and the development of employment criteria. One of the enterprise zone subcommittee's strongest concerns was that, in the case of Baltimore, decaying industrial areas—and not necessarily residential ones—would be the optimum locations for targeted areas. This concern stemmed from certain geographic realities of Baltimore. This might not be the case in other cities.

Moreover, hardcore unemployed, economically disadvantaged people should not be precluded from employment in targeted areas simply because they are not residents of such areas. Given the geography of Baltimore, requirements of residence for employment in targeted areas would be ridiculous. How many people live in dilapidated industrial areas? In such cases, flexibility is needed in establishing the proper employment criteria. In Baltimore, CETA eligibility may be the best standard for employment.

While Federal, State and local governments have all provided various forms of assistance to small, developing businesses over the years, excessive redtape has been the biggest obstacle to their use. Small entrepreneurs usually are ill prepared and uninterested in complying with the prerequisites attendant to Government assistance programs and benefits. Excessive forms, licenses, paperwork, legal fees, waiting periods and other problems deter even the most persistent small businessman.

Let me give you an example.

Several years ago at Carey Machinery I was desirous of raising capital for expansion within the city, although not in an area that would be considered a targeted zone. I identified a capital need of $300,000 but did not feel I could afford to borrow this from a commercial source; hence, I decided to investigate the utilization of the industrial revenue bond process.

After looking at the front-end legal costs and the administrative requirements, I was forced to scale down my expansion requirements by one-half and, in fact, went back to a commercial loan instead.

All levels of government, sincere in their efforts to assist small business startups, must become sensitive to the redtape problems. Unless programs provided in targeted areas are better suited to the needs and capabilities of embryo businesses, they will be as ineffective as the assistance programs of the past.

I hope that my comments will help shed some light on the problems associated with promoting and encouraging urban revitalization and job creation. I know that my remarks today and, indeed, the concerns of the GBC enterprise zone subcommittee, are not entirely optimistic. As I have said, though, there are no ready-made solutions to this problem.

It is, however, encouraging to see Congress, and particularly this subcommittee, trying to develop responses to the many problems inherent in developing legislation to target distressed areas. I think legislation providing for several well-chosen pilot projects which permits broad flexibility will be the best approach for now.

I would be happy to respond to any questions that you all might have. I thank you.

Mr. NOWAK. Thank you very much for both your testimonies.

It seems difficult to devise specific answers to all the variables that are out there in the universal community. What is an incentive to one area may not be an apt incentive to another area. But we are certainly going to make an effort in bringing all this together. I think both your testimonies will help us in that regard, because it is based upon your practical experience and what could possibly be the elements of a successful enterprise or urban strategy.

Let me ask a couple of questions first of all, of Mr. Carey. You mentioned counseling services, which brings us into a very important element that we touched upon last week and that is the training of skilled labor or the counseling services for a broad spectrum of the business community that you alluded to in your testimony.

I wondered why you felt those are absolutely necessary.

Mr. CAREY. Mr. Chairman, when I was working as chairman of CEBO, I got a great deal of feeling for the kinds of problems that small disadvantaged businesses in this case would face. And just starting a small business, under the best of circumstances, is a tough job any way you look at it. I don't have it at my fingertips—and I'm sure you all do—the failure rate for small businesses. And when we are going to add to this the problem of putting them in a targeted area, with a request or a commitment to employ a certain proportion of untrained people, you begin to burden these entrepreneurs with an almost insurmountable obstacle to success.

I think of the loads we can take off their back is to help them with these disadvantaged workers in job counseling, as I am sure you have talked about and will talk about, the simple facts of getting them to work on time and every day, their problems at home, the drug problems which are rampant in these areas of the cities. In this way we can perhaps improve the odds for success. It's enough of a burden to start a business anywhere, whether it be in the counties, the surrounding areas, and I think it is necessary in the inner city.

Mr. **Nowak**. What type of new businesses do you believe would be attracted to these areas if we were to develop a broad sense on these incentives?

Mr. **Carey**. I think it is very difficult to say. In our testimony of witnesses before the Greater Baltimore Committee we had one example which was a small manufacturer of high-fidelity portable radios who was going to move his business from New York City to—I don't see any New York City members here—but moving it from New York City to the Park Heights area. Another would be a small manufacturer of heating pads, with their own moisturizing elements. Nothing significant. No Haloid Xeroxes yet on the horizon, but just a whole span of them. Even conceivably in distribution, if we had to expand we would consider the enterprise zone for auxiliary warehouse-type operations.

Mr. **Nowak**. The wholesaler-distributors possibly could use, I would think, an entrance into some of these areas. Do you feel there is an opportunity for that?

Mr. **Carey**. Yes; I do. We recently had occasion to look for additional warehouse space and we picked what was available. But given these kinds of incentives, and also my involvement with minority businesses, I could see how we might take advantage of some enterprise zone like this.

Mr. **Nowak**. Mr. Hash, just let me ask you one question. You talked about additional incentives—I don't know when this testimony was put into effect. But what additional incentives do you see from a tax point of view, other than accelerated depreciation, which would be of some value to someone who owned the building perhaps rather than a rental or lease situation? Is there anything else over and above what we could use to complement the tax code changes?

The State changes were very meaningful, and this committee had several hearings, and then we went over to the Ways and Means Committee and testified to changing the State tax exemptions. They approved almost the level we had suggested after these hearings. That, of course, was a universal kind of incentive to save money and retain money, to build a business up to at least the $675,000 level without incurring any loss on the passing of your spouse. But other than what we have put into the tax code, what do you think would be the type of incentives that would make some sense and complement those changes?

Mr. **Hash**. Well, I would say that the most important change would be in the accelerated depreciation area as opposed to other tax-related adjustments.

Mr. **Nowak**. Let me ask this question because it has come up in several other hearings, especially for labor intensive business or, in fact, for any business that hires employees. We have been looking at the jobs tax credit, considering bringing that back and tying it in with some type of additional dollars or incentives for the training period of an unskilled worker, to make him a worker who actually becomes someone who contributes to a business rather than just draining off the skills of someone used to train that person.

I am wondering if you feel that would be a help, if someone had a small labor intensive business of, say, 15 or 20 people, leased the building and actually started to make some money, if that money could not be reinvested and perhaps some day used to buy their own building? How do we get that capital formation staying internally within the organization?

Mr. **Hash**. I think, Mr. Chairman, you probably put your finger on one of the interesting points, really a challenge to get that reinvestment on the part of the firm that is getting the benefits up front, getting the incentives, if he can at some point in the future turn that back into more capital investment, expansion or whatever. We have not considered mechanisms for that, but it would appear that if there is a major savings, operating savings, labor cost savings or whatever up front as a result of these targeted job tax credits, that it would make sense to consider some way of turning that back around. But I can't comment on the mechanisms for that. But it is interesting.

Mr. **Nowak**. If you could give that some thought and perhaps when you go back you could detail some explicit additional incentives that you think could complement that tax law. I hope you will look at that jobs tax credit, especially in the training area.

Mr. Roemer.

Mr. **Roemer**. Thank you, Mr. Chairman.

To follow on that same line of questioning, Mr. Hash, you talk about the accelerated depreciation, and perhaps in my too simple view of the world, in looking at the tax bill, I would think that the provisions we have already passed for accelerated depreciation actually make depreciation more generous than expensing now.

I wonder what else we could do in order to reward those who invest in plant and equipment. Do you have any specific ideas, or were you just generally concerned about that area?

Mr. **Hash**. Mr. Roemer, let me try to give you an example of why we think a more accelerated schedule would be important.

When you look at the category of small business which might fall into the area of either branch plants or a firm that would be taking the second or third expansion step in its evolution, the firm would be profitable and the firm would be, in addition to that, looking at an investment of, say, $4-$5 million to build a new plant, maybe 100,000 square feet. The plant might employ maybe 100 people, sort of a middle-sized type operation. If we had an accelerated depreciation incentive where that firm could write off a major portion of that investment over a very short period of time, I think you're talking about having a very important incentive as compared to what is available now under the Economic Recovery Act.

I think that the tax bill has certainly taken a step forward in that area, but I think some of the earlier provisions of enterprise zone legislation at least suggested an even more ambitious accelerated depreciation schedule which we would like to see reintroduced.

Mr. **Roemer**. I see. You're meaning a shorter timeframe than either 3 or 5 years, or shorter than 15 years for a building?

Mr. **Hash**. When you're talking about major investments in real estate and building work, then I think 15 years is too long. You are missing those firms that are making what I think is the more ordinary investment and expansion decision you know, "Am I going to do this in the city; am I going to do this in the suburbs. I've got to do it if I want to make money." Let's see if we can't make it happen in the cities.

Mr. **Roemer**. I see.

In line with what Mr. Carey said, which I thought was an excellent point—obviously I agreed with it—in light of the fact that small business in general would be more attractive to nontax incentive, given the fact that many of them are marginally profitable, even if that, do you have any specifics in that area? I think he mentioned seed capital, for example. Does your team or your experience lend you to suggest anything in that area specifically to us?

Mr. **Hash**. We are trying to look at a balanced approach to attracting investment and business development in these zones. What I just described on this accelerated appreciation example obviously is not a startup small business. It's somebody that has been in business for several years and is taking that intermediate step.

Mr. **Roemer**. A second plant.

Mr. **Hash**. Second plant, third plant. As far as small business development is concerned, in one of the areas that I refer to in the remarks, the Park Circle Industrial Park, we are taking a concentrated approach to small business development through the business and technology center activities that were referred to and are being implemented by the Control Data Corp. The business and technology center will be about 100,000 square foot combination office and manufacturing facility. The office portion will have different commercial uses, business service type uses, accounting, banking, legal services, et cetera, that will be of benefit to small business development within the industrial portion of the building. We are trying to get small firms, particularly startup firms, to locate in the industrial portion of the business and technology center and with its colleagues, with the other tenants in the building will take advantage of the shared services.

Along with that, as I mentioned the seed capital, working capital problem needs to be addressed and we are trying to work out some way of setting up a loan pool, venture capital pool that will be available to these small firms.

So what we are doing at Park Circle, we have a 40-acre industrial park that we are marketing, and developing incentives to attract the middle-sized branch plant type of a firm that can take advantage of these tax incentives and are labor intensive as well as capital intensive.

Along with that we are trying to generate new firm startups in this business and technology center which we hope will be an incubator space for these firms who will eventually expand and go through the cycle in the industrial park or in other sites in the city.

Mr. Roemer. Very good. With the chairman's permission I have two other questions. One for you and one for Mr. Carey.

In your direction again, you said in your initial statement that you tended to agree with the former mayor of New Orleans, Mr. Landrieu, that a combination of programs—I think it was you that said this—is in order and the kind of synergistic action that we derive therefrom could be greater than any single program.

But also Mr. Landrieu said that in his experience some of the programs perhaps could be cut back, which were not totally successful, might be phased out. Do you share that feeling that although a clustered approach is the best approach that some programs in that cluster are not working up to speed and might be changed? Would you comment on that?

Mr. Hash. Mr. Roemer, let me answer that by taking a more positive approach and say that there are a number of programs out of the Economic Development Administration and out of HUD that we have had very good success with, and in fact without these programs we wouldn't be able to tell the story in Baltimore that we are able to tell today. The public works programs of EDA have been critically important to Baltimore's activities in the industrial economic development area as have the urban development action grant program of HUD.

Just to give you a quick example, we used EDA's title IX economic adjustment program in the midseventies to develop vacant land—actually an old Army fort—and converted it into an industrial park. We put in roads, utilities and so forth and we have about 170 acres of prime development area near the port. Fortunately, the industrial park is located very close to an assembly plant operated by General Motors. We were able to offer property at the industrial park, as much as 50 acres, as an alternative to what GM was considering at the time and that was to close the plant down and build a new plant in the suburbs or somewhere else.

Mr. Roemer. In Shreveport, I think, where I'm from. No, go ahead.

Mr. Hash. Actually, some of the Baltimore employees were moved to Shreveport.

Mr. Roemer. They all called me.

Mr. Hash. We were also able not only to offer property at our industrial park that was developed with EDA funds, but we were able to put together another package of incentives that included rebuilding access roads to the old, obsolete plant that General Motors was operating in the city, and we made application to HUD for about a $13 million urban development action grant. We were successful in getting an award so I can say that without EDA and without HUD's UDAG program General Motors maybe 1 year ago, 1½ years ago, would have pulled up stakes.

Mr. Roemer. I see. Maybe you didn't understand my question. Maybe I did a poor job of phrasing it and that's certainly possible.

Let me try it again, just briefly from me and briefly from you, if we could.

Do you agree with the former mayor that some programs in view of our need to cut back where we can, could be cut back if measured on the bottom line of their effectiveness at creating jobs and letting business thrive and communities grow. In your experience are there any programs that we might look at as a committee that might be cut back, phased out, and in return put in a different form of investment like these urban enterprise zones? Is there anyplace we can get money from?

Mr. HASH. Mr. Roemer, what I can't do is itemize those programs that are less effective than the ones I am referring to. But what I would suggest would be to take a look at the whole spectrum of programs that are available in the area of urban revitalization and to see whether those programs would be made more effective with less outlay by the Federal Government if they were concentrated, targeted, in a format and in an environment that is established by enterprise zones.

Mr. ROEMER. OK. Thank you.

Mr. Carey, if I could try you on one. You mentioned interestingly so to me, about the need I think you phrase it in terms of personal infrastructure or something like that, the need for these programs in these targeted operations to consider the whole person of employee training, et cetera.

Have you had experience with CETA in your operation or your personal experience and how would you judge our CETA efforts and our CETA money in terms of what you think needs to be done in these underdeveloped, if you would, areas. Is CETA the right way or should we replace it with something else?

Mr. CAREY. Mr. Roemer, directing an answer to your question, no, I haven't had personal experience with CETA-trained people, although we have recently acquired somebody under on-the-job training or WIN. I am not sure which of the programs, but it wasn't CETA. But we look to CETA, particularly the effort going forth in Baltimore now to find private sector jobs for the CETA trained people.

Without really close or thorough knowledge of the program, my impression is that there are very good parts of the CETA training that will supply workers who could be gainfully employed in these enterprise zones as well as the private sector everywhere. I was trying to think of an answer to your question to Dave. It is hard for me to pinpoint programs that might be cut out. I know what you are struggling with and where to get it to put it here.

If I might make a suggestion along these lines, not so much a program but it is some of the thrust of it which I saw as chairman of CEBO which started out as Ford Foundation seed money and ended up with money flowing in through every conceivable channel of Federal, State and local government. We spent entirely too much time justifying our existence and getting the moneys through minority business commerce, I guess, and HUD money. We spent entirely too much time justifying our existence in terms of numbers. How many people did we handle? I can understand the reasons for this too, but we weren't held accountable for results. How many minority businesses did we birth that really—I looked for success and the CEBO program is businesses who could walk away and leave us. Leave their shrink and get out there and fight in the real world. We weren't held accountable for that so much as we were held accountable of how many businesses did you give counseling to this week, so you all could crank it through your Federal computers. This to me is perhaps more of a relevant way to find moneys to put in something like these targeted areas than wipe out whole programs. Look for better results. Result oriented rather than, you know, so much money into getting the job done.

Mr. **Roemer**. I thank the chairman for having you all come and I thank each of you for your testimony and just conclude by saying that one of the most relevant things that each of you said and are united on is the fact that whatever programs are devised ought to minimize the redtape and maximize the results. And I thank you for that.

Mr. **Nowak**. Thank you very much.

Mr. Centner do you have a question?

Mr. **Centner**. Just curious. Mayor Landrieu made a comment that I have been reflecting on and I thought I would ask both of you since you are involved in a city that's made a real effort to make a comeback here in recent years.

You pointed out that cities go through cycles and indeed they do. Williamsburg was once the chief city in Virginia; LaPorte was in Colorado—how many of you remember LaPorte? Morgan was in Utah. During the 1960-70 period, Amarillo lost population, probably to Lubbock's benefit. Santa Fe was the chief city in New Mexico; Albuquerque is today. Nobody suggests we go back and revitalize Santa Fe, LaPorte, Williamsburg or any of these other places. Cities are places where people decide—for commercial, industrial, recreational, quality of life reasons and so forth—to live in proximity to one another. I am just wondering if this isn't kind of a natural thing we are going through here; and, as a matter of fact, as Baltimore and other cities have lost population, Tysons Corner has benefited; Salt Lake City has benefited; Tucson, Ariz. has benefited; Phoenix, Ariz. has benefited. Why should we revitalize the cities? I mean, why not let them go through the cycle and let the marketplace decide where people are going to live rather than throw money into a place where people obviously don't want to live, or haven't wanted to live in recent years. There has been sort of an unstated premise that all this is a good thing, and I am hoping Dr. Butler will address this later too, because I know it is an argument that's been made by some of the people at The Heritage Foundation. I am curious as to how you would respond to that. If we let them go through the cycles, you may end up with the city somewhere else other than Baltimore, in other words. I realize that. But that's happened before and it will happen again. Why not let it happen naturally?

Mr. **Hash**. Let me take a shot at that. I think your view of cities, if you look at history, I think it's true that cities waxed and waned, depending on different factors. I think in 1700 and 1800 you are talking about cities that were developing based on economic factors such as their location, trade, probably is the main reason why certain cities flourished and certain other cities never made it. When you have an economy in today's terms which is moving away from an industrial base and moving more toward a service sector type economy, you are going to see very little change in, you know, sort of a raison d'etre for cities. What you might see is—within a city you might see neighborhoods changing, which I think is something that is a fact of life and is built into the economy. You are not going to see cities come and go like you saw cities come and go in the last couple hundred years. Cities are built around a fabric that I think in some places is soft and some places is very stable. What we are trying to do in Baltimore is to make those stable areas even more stable, to strengthen them and to try to hold on to what we have, what we have got in the areas that are softer.

We are not saying that we can bring everything around, but if we don't, then I think we are going to be in a worse off situation.

Mr. CENTNER. Well, I agree Baltimore would be in a worse situation, but my point is, people are obviously making a choice to live somewhere and more people are living, as I mentioned, in Tysons Corner, than perhaps in Metropolitan D.C. now. My question is this: Why should the Government go in, put money in and create an artificial incentive that wouldn't otherwise exist, to try to persuade people to live in an area where they wouldn't otherwise live? I mean, wouldn't a new city start—or not a new city possibly; maybe cities are a thing of the past. Maybe we are talking about little population centers all over the place. Why is the city, as it is right today in 1981, sacrosanct in a way that makes urban revitalization such an important goal? The premise has never really been examined, I don't think, and it is not just at these hearings. It's been everywhere on Capitol Hill that you talk to anybody. It is sort of an assumption.

Mr. HASH. Let me try to get at it from one other angle, then I'll let Cheddy Carey respond, if you'd like.

If you had places like Tysons Corner and Tucson, et cetera, if you had those areas developing proportionate to the situation in older cities like Baltimore, then I think you are talking about a situation, or a trend. It would be awfully academic. What's happening is the problems of older cities are not being transferred to Tysons Corner and to Tucson. In fact what you see is that those problems are being accentuated by these migrations to other areas. And you have a growing disproportionate burden that is having to be addressed by the cities. I guess I would turn the question around: What do you do about the city that becomes a repository for the old, for the impoverished, for the unemployed? I would hate to see a city like Baltimore in 20 years be nothing more than an enclave for all the derelicts of society. And I think if the trend continues everyone going out to the suburbs, to the new growth areas and so forth, I think certainly everyone ought to be allowed to choose where they live and where they work, but I don't think that should be done at the expense of cities like Baltimore.

Mr. CAREY. I would concur with what Dave said and particularly stress the fact that I don't believe people or market conditions are going to transport people that easily. Sure, they are going to transport nurses these days, or tool and dies or tool and diemakers, or computer programers that are hot numbers, but the kinds of people we are talking about in Baltimore and Buffalo, and New Orleans, they aren't going to make it in Tysons Corner. And Tysons Corner probably doesn't want them either. So that there is the job to be done right where they are. And the other thing is that these cities—you have got big plants like Black & Decker out north of Baltimore, beautiful rolling country, but Black & Decker depends heavily on the services of the city and I don't know where those services would go and the country's going to depend very heavily if we can get our port dredged, it is going to depend very heavily on Baltimore for bringing coal in and exporting coal and foodstuffs and things like that. So I think that there is a real reason to save a city like Baltimore and I am sure—or in Buffalo or Shreveport—there are other reasons, too. But basically I think you have to come back to the people. You are not going to transport those people.

Mr. CENTNER. Thank you, Mr. Chairman. I just didn't want to let the premise go unstated. I think it is important that we know why we are going in the direction we choose.

Mr. NOWAK. Thank you very much. We'll excuse this panel and thank you again for coming. The broad question, of course, revolves around why have an enterprise zone. Why not throw out general tax incentives. And of course, in that way affect everybody in Tysons Corner and also in Baltimore. At the same time I guess we have got to make decisions why build dams in certain areas of the country, why expand our waterways and why this highway system built with 90 percent of funding for Federal highways? Yet, when you analyze the ultimate decisions and directions, you go back to the State and local levels because that's where we see the systems suggested and designed. So it does really intermingle with all the other priority decisions that we make.

But again, thank you very much for coming and if we have any further questions, we'll get back to you as we develop the report on these hearings. Thank you.

PANEL CONSISTING OF M. CARL HOLMAN, CHARLES F. ROSENOW, AND WILLIAM WEISS

Mr. NOWAK. Our next set of witnesses will be the National Council of Urban Economic Development and along with that testimony we would also like to call Mr. William Weiss, who is president of the Rotary Co., Buffalo, N.Y., and the third panel member will be the National Urban Coalition, represented by Mr. Carl Holman.

It has been mentioned, especially last week when we had the hearings, that there is a skilled labor shortage in certain industries and this whole concept of training and counseling was mentioned by the previous witnesses. They discussed very prominently the question of development of labor skills that are necessary for an initial business to operate, and progress, and to expand. Mr. Weiss is the president of a sheetmetal working company in Buffalo who has for many years been interested in the training and has gone through the practical experience of training highly skilled workers and then have them leave to work for larger corporations. Thus, he has expended tremendous sums of money, I would imagine, in their training, in an effort to keep them contributing members of his firm or other firms like his in Buffalo.

Mr. Weiss, we would be interested in hearing your testimony. Your statement in total, of course will be inserted in the record and you may proceed in any way you like.

TESTIMONY OF WILLIAM WEISS, PRESIDENT, ROTARY CO., BUFFALO, N.Y.

Mr. WEISS. Thank you, Mr. Chairman.

Let me say firsthand that I have been trying for 20 years to get an ear in Washington to a committee like yourselves through Mr. Pillian, Mr. McCarthy, and Mr. Kemp, and you are the only one that so far has responded to my letters. It is not the first time I have written. I have written time and again on this problem of lack of skilled help in this country and it is on this basis I would like to read my remarks to you.

These hearings by your subcommittee recognize the fact that our country is falling behind in the training and education of the next generation of craftsmen in the various vocational disciplines. Historically in the past, replacement of craftsmen was to a large extent accomplished by immigrants from European countries and their first generation offspring.

For all practical purposes, this influx has stopped, indeed in some cases emigration has taken place to fill vacancies existing throughout the technically oriented countries of Europe. The result is a virtual famine of trained craftsmen.

Various training programs have been established on the Federal level, the latest of which is CETA. These programs without exception did not live up to their expectations. The cost to the taxpayers is prohibitive.

In my company the scarcity of skilled help is impeding our growth as the best employees retire and no skilled help is available to replace them. While we have always trained some people for our special requirements, it is also our experience that large corporations stole them away from us just when they became cost effective to us. We cannot afford this to happen and yet we are presently hiring young people from vocational training schools, where they receive basic training and technical instructions in certain trades. Mostly such training is for machinists and welders. No training is available for our type of sheetmetal work or some other types of trades. We hire these young people at starting wages roughly twice the minimum wage and hopefully we can retain enough of them, once they can function profitably for our company.

Rather than rely on the fragmented and inadequate manner now employed by individual companies, we should establish a well organized apprenticeship program for all trades on the Federal level. For example, we only need to study the systems employed by the various European countries, pick the best features from each and fashion a system suited to our requirements.

Basically the best way to train apprentices is by a "hands on" system where they are exposed to actual factory conditions in conjunction with a school partnership, where perhaps 1 day per week is spent learning the technical side of a particular trade. Additionally, the system should be flexible enough to be tailored to special applications within the general framework of a particular trade. After all, the end result of any training system should be steady employment in the local industries. One reason for the lack of craftsmen, especially in the construction trades, is, that unions put limitations on the number of apprentices and in addition demand wages completely out of line with reality. It costs a lot of money to use skilled people as teachers and the high cost involved limit the opportunities for would-be apprentices. We have a valuable pool of retired craftsmen who with a little incentive taxwise, could function as teachers in the vocational schools which form the partnership with practical shop training. These people would work for relatively low salaries, as long as they would not have to sacrifice part of their social security pension. Aside from the cost of the technical schooling, the system should cost the taxpayers next to nothing, nor would it take a huge bureaucracy to supervise it within general guidelines.

The States could, through already functioning labor departments, see to it that the apprentices are put through an established routine during the period required for learning the basics of a trade. Such periods may vary from 2 to 4 years depending on the complexity of the trade. A suitable practical and technical exam at the end would entitle those who qualify to a certificate of competence, which a potential employer can accept as a basis for hiring an applicant. To glamorize blue collar work, selected top graduate apprentices from around each State should receive media attention and perhaps a visit to the Governor's office to receive a token of merit.

It would be advisable to allow employers who train apprentices some tax relief to make up for part of the cost involved, at least during the initial training period, where apprentices are more of a liability than a help. Otherwise the Government should not be involved except for easing the reporting requirements now demanded.

An apprenticeship system which would channel young people of 16 years via expert career counseling, into trades rather than academic studies they do not like, would guide their energies into useful channels while they earn a wage. Additionally, this would reduce the juvenile crime rate caused by enforced idleness of youths who drop out of school with no hope of ever being assimilated into the work force.

The foregoing suggestions assume that our public schools turn out graduates who master the basic three R's. Industry cannot be expected to assume that task. Admittedly the present situation cannot be reversed in the short term, but a beginning must be made; the sooner the better for the good of our Nation.

These are my remarks. Thank you.

Mr. NOWAK. Thank you very much, Mr. Weiss.

We will hear now from Charles R. Rosenow, who is the director of public investment, Erie County Industrial Development Authority. He is responsible for the city of Buffalo, Erie County industrial park and industrial development therein and someone who also I might add, Mr. Weiss, I am sure will take back your remarks to the agency. We have developed the private industrial council to do some skilled training which hasn't the broadness of the concepts that you have presented here today, but I am sure if you haven't already met him, you will meet him after the meeting and I want you to talk to him long and hard.

TESTIMONY OF CHARLES F. ROSENOW, DIRECTOR OF PUBLIC INVESTMENT, ERIE COUNTY DEVELOPMENT AGENCY, ON BEHALF OF THE NATIONAL COUNCIL OF URBAN ECONOMIC DEVELOPMENT

Mr. ROSENOW. Thank you, Mr. Chairman.

It is indeed a pleasure today to be here to discuss the Enterprise Development Act of 1981. In light of being I think the fourth or fifth speaker, I am going to skip over a number of the comments that are in my statement that were already made in other statements and just go directly to my comments.

Mr. NOWAK. The total statement of course will be incorporated into the record.

Mr. ROSENOW. Thank you.

I am here today representing the National Council for Urban Economic Development. It is an organization with 1,500 members from over 400 cities that implement on the local level economic development activities.

I am going straight to the suggestions for changes in the proposed bill. We will make a comment on the development strategy, that although in practice it is carried out in this fashion, the bill itself does not reflect the fact that the practice of EDA in using the strategy as a tool is to draw together all the resources at the local level. Be they public resources or private resources, they should be brought together into a well thought out program for reversing some of the economic conditions that prevail in distressed communities.

We like the concept of the national advisory committee on regional economic development and would state that this should focus on establishing a national public investment policy.

One of the ways that the assistance can be targeted to an additional extent as is the case in the current title IX program, is to target assistance to basic industries whenever possible. One of the views is if the bill is a jobs bill, then it probably makes sense to have the job expansion zones targeted to all companies. But if the major work of the bill is for longer term economic development, perhaps there should be some attention put to what types of businesses are primarily necessary for development of the community.

We also make the comments which I am sure you are aware of, that in light of the new economic recovery act tax incentive bill, certainly there is a need to reexamine a number of the incentives that are in the current bill. We would state that there would be a need to make a significant differential in any tax incentives, if the job expansion zones are to be attractive. As an example the 25-percent rehabilitation tax credit in the current bill is not terribly different than the 15- or 20-percent credit in the general tax bill.

Seed capital is extremely important to small businesses. The refundable investment tax credit with the $100,000 limit we think would be the most effective tax incentive that's currently in the bill. It is targeted mostly to young and small startup companies who would have the greatest benefit. The council does support the legislation's intent to target jobs to areas but we do point out that the residency requirement could be a cause for substantial administrative and enforcement difficulty. Unfortunately, residency requirements don't work very well even in municipal government and we would propose that there be some form of "carrot" for hiring residents rather than a requirement. The targeted jobs tax credit we believe should be deepened perhaps further than it is. Again the new tax bill does continue that tax credit and we believe it should be deepened further within a job expansion zone.

On area eligibility requirements, we would suggest that insofar as possible that a UDAG criteria be included within the bill. It's an acceptable measure of economic distress. It is well understood, I think, and accepted out in the various areas around the country and it is similar in many respects to the criteria outlined in the bill.

The length of the designation for any job expansion zone—we believe 10 years would be the minimum time. The major need here is to provide some certainty to business that in return for locating in any area there would be sufficient time that would match the growth of the company. There is a question on the number of zones and in light of the concerns over possible effect on the Treasury, we believe that the zone should be limited either in a demonstration period or to the same number each year or on the other hand that the tax incentives themselves might be more fully targeted within the zones. Either way I think would be a good approach and there would be a need for periodic evaluation to insure the appropriateness of these tax and financial incentives.

And finally, in summary, I would just echo the other speakers. It has been our experience in Buffalo that the use of the title 9 program would be only one facet of our overall strategy and within our overall strategy we have room for both other Federal programs—we perhaps stand toward the top of the list in New York State in the amount of local property tax abatement that's authorized both by the State and by local governments and also we integrate within the strategy various commitments from the private sector.

So the bill is certainly not going to be an end-all toward innercity development but it certainly will be a welcomed addition. Thank you.

Mr. Nowak. Thank you very much, Mr. Rosenow.

[Mr. Rosenow's prepared statement follows:]

PREPARED STATEMENT OF CHARLES F. ROSENOW, DIRECTOR OF PUBLIC INVESTMENT, ERIE COUNTY INDUSTRIAL DEVELOPMENT AUTHORITY, BUFFALO, N.Y.

Mr. Chairman and members of the committee: It is my distinct pleasure to be here today to discuss the Enterprise Development Act of 1981 (H.R. 2965). This legislation which would target various forms of financial assistance and tax benefits to areas of severe unemployment and disinvestment is of great interest to the National Council for Urban Economic Development and its more than 1,500 members who plan and implement economic development activities in over 400 cities around the country. The legislation's employment and capital investment incentives have the potential to bring new economic vitality to areas which have been written off as seemingly hopeless due to their grave and continuing social, economic, and physical problems. The emphasis of the legislation on small business is particularly important to distressed cities because of the employment and revenue potential of small firms and the greater ability of cities with limited land and excess industrial space to accommodate and facilitate small business development.

Before addressing specific provisions of H.R. 2965, let me first express our pleasure at the inclusion of direct economic development assistance as provided in title I of the bill. In previous congressional testimony, we have expressed our reservations about the potential pitfalls of relying solely on tax incentives to stimulate investment and employment in severely distressed areas. Tax incentives alone are not enough to make one project go or to revitalize an entire area. Private investment only occurs if the total "environment" is conducive. The components of this environment—each of which must be present for development to take place—include:

1. Availability of developable land or space at a competitive price.
2. Existence of infrastructure and other supportive services.
3. Availability of low-cost capital.

4. Equitable tax system.
5. Trained manpower.
6. Public sector capacity to assist development.

Thus, it is a complex combination of these physical, financial, and labor components which make an area ripe for investment. In assessing the potential success of job expansion areas, we must examine what other elements are needed before private investment will occur. Local experience has shown us that tax incentives or abatements work only at the margin in stimulating private investment and are not enough in and of themselves.

The direct financial assistance to be provided through EDA is critical to the economic revitalization of distressed urban and rural areas because it gives them the ability to provide the missing component, whether it be an upgraded highway or a low-cost loan, to make the private investment happen. Finally, we are pleased to see that the bill's direct financial assistance embodies the flexibility of EDA's current title IX program. Local development practitioners have found the title IX program to be particularly useful in their development efforts because of its broad range of eligible activities, its targeted focus, and its basis on a specific development strategy. The establishment of local revolving loan funds such as the one in Buffalo demonstrates how the public sector can improve the investment climate of a particular area and get a return on the public dollar.

Our suggestions for improving the title I program relate to the required development strategy, the advisory committee, and the use of the funds.

First, the legislation's requirement that an area have an approved development strategy, similar to the long-range corporate strategy used in the private sector is an excellent way to determine the allocation of public resources among various economic needs. We believe the requirement should be further defined so that the community will describe the types of services and activities to be provided to the targeted area. This local public investment forms the basis for additional State and Federal assistance and gives the private sector some measure of certainty as to the types of public services and resources to be maintained.

Second, we welcome the creation of the National Public Advisory Committee on regional economic development. However, we suggest that this body focus on establishing a national public investment policy. The administration's economic recovery program and the recently passed tax package focus solely on the private side of the investment equation. Without the necessary public participation in providing infrastructure, land, and job training, national and local economic revitalization will simply not occur. It is critical that we now devise a national policy which links and targets all public investments, particularly in areas which are suffering from long-term or unique obstacles to private investment.

Finally, the economic development assistance should be targeted to basic industries whenever possible so that permanent employment is created and productivity increased.

Before detailing our suggestions for the tax incentive component of this bill entitled the "Urban Development and Job Expansion Act," let me establish our overall concerns. The tax incentives provided in this and similar bills must be examined in light of the recently approved tax package. There must be a significant benefit differential between general business tax cuts and those available to firms which locate in job expansion aras favoring investment in the designated area. As I stated earlier, tax incentives are only one part of the investment decision and only work at the margin. There are many other factors involved in a firm's decision (transportation access, financing, market, etc.) which are far more critical. However, when tax liability is a factor, the incentive must be deep enough to have an impact.

For example, the 5 percent investment tax credit for new, nonresidential structures and used property contained in H.R. 2965 may not be a sufficient incentive given the general tax bill's increase in its rate and used property limitations. Similarly, the 25 percent rehabilitation tax credit, though an important incentive, must be compared to the 15 and 20 percent credit available for all qualified rehabilitations regardless of location.

The existence of seed capital to encourage business startups and expansions is critical to the success of job expansion areas.

The inclusion of a refundable investment tax credit up to $100,000 is perhaps the most important tax benefit in the legislation. Small businesses, which are the most likely to locate in the zone and have the greatest employment potential often lack sufficient tax liability to take advantage of tax credits. Furthermore, they are cash poor and need funds to expand their businesses. This provision, coupled which the revolving loan funds provided through title I and the less stringent leveraging restrictions on small business investment companies are important potential sources of seed capital for firms located in job expansion areas.

CUED supports the legislation's attempt to insure that the jobs created in the targeted area are given to those who need them, particularly area residents. However, we suggest that this purpose be achieved with a "carrot" rather than a "stick." The requirement that 50 percent of the hours of service be performed by area residents in order for a firm to qualify for the special tax benefits may be too restrictive. This provision could discourage some businesses from locating or expanding in the job expansion area and could be particularly burdensome on small firms with unique skill requirements. Given the limited amount of tax incentives available, the paperwork related to enforcing the residency requirement could be enough to limit private expansion or location in the area.

Furthermore, we are concerned about how this provision will affect existing businesses. In most cases, they will be unable to meet the 50 percent requirement and should not be penalized. Applying this requirement to new employees in existing businesses is an option, but we favor dropping this requirement for all firms.

To insure that firms hire the unemployed, sufficient incentives are necessary. Given our experience to date, the targeted jobs tax credits provided in the bill should be deepened even further. Furthermore, they should be made available to all CETA-eligible persons to insure coordination with local employment and training systems and to avoid hiring residents who are not needy. If residency is important to a community, preference can be given to individuals who are CETA-eligible and residents at the local level.

To encourage retention so that workers can get the necessary training and experience, we suggest that the firm should not be eligible for any tax credit until the worker has been employed 6 months. The credit would then be retroactive to the date of hire.

However, the potential of these or other employment tax incentives is still limited. No employer will hire someone who is not able to perform the work regardless of the incentive. It is just not good business. Job training is what is needed to insure that firms hire the unemployed. Ideally, additional employment and training funds for the zones in coordination with local manpower and training centers or private industry councils should be provided to the job expansion areas.

The eligibility criteria for the job expansion area are appropriate measures of economic distress. However, rather than the proposed rating system, we suggest using the eligibility criteria of HUD's urban development action grant program. The criteria, namely unemployment, per capita income, poverty, and so forth are similar to those in H.R. 2965 and are an accepted measure of economic distress. Use of the UDAG criteria could also improve the coordination of job expansion area activities and UDAG funding.

The 10-year limitation on the tax benefits for firms in job expansion areas is the minimum to insure a level of certainty for private investment and to determine the economic success of the area. We recommend an additional 5-year phaseout of the incentives, particularly for firms which might locate in the zones in years 7, 8, 9, and 10.

Given the current budget situation and the growing concern over the budget deficit, we suggest a limit be placed in the number of zones designated each year. Perhaps, 10–25 zones per year should be considered.

Finally, this effort to stimulate private investment and employment in targeted areas should be evaluated annually to insure that the types and level of financial and tax incentives are effective in stimulating economic revitalization.

In conclusion, I would like to reiterate that this initiative is only one part of what's needed to facilitate the birth and expansion of private investment in distressed areas. The prerequisites for investment that I outlined early in my testimony require the use of many development tools and the full and active support of both the public and private sectors.

Thank you.

Mr. **Nowak**. Now we will have our next panel member who represents the National Urban Coalition, Carl Holman, who is president of this organization and has been the president since 1971. We welcome you before this committee on this particular subject.

TESTIMONY OF M. CARL HOLMAN, PRESIDENT, NATIONAL URBAN COALITION

Mr. **Holman**. Thank you, Mr. Chairman.

The Coalition has been interested in this whole question of enterprise zones since we began having some conversations with Mr. Kemp and Mr. Garcia many, many months ago. One of the points that my good friend, Moon Landrieu, has made, that others have made, and we continue to make is in the testimony which we presented before the Senate. We would be happy to share that with you along with our full testimony here, should you be interested in it.

Mr. NOWAK. We'd like that testimony submitted for the record.

Mr. HOLMAN. OK. I'll try to make some points not trying to repeat everything that's in the testimony we submitted.

As an experiment—and the enterprise zones do represent an experiment—I can understand the reluctance that Mr. Kemp, for example, has expressed in terms of not wanting to, as he said, "Christmas tree" the bill. But as I tried to point out and as others have tried to point out you can load the dice so against an experiment like this that it can't possibly succeed. If for example, you're killing UDAG, you're killing the job training programs, you're cutting back heavily or cutting out EDA, SBA, and you create a situation in which it would be something like a miracle if this experiment might work.

I spent a little time in London under the auspices of the London Chamber of Commerce, which was having an inner city conference. Except for a couple of us, there was clearly in those five country delegations nobody who had spent very much time in an inner city. But I found out in talking to the department that has the responsibility for enterprise zones there, that this is a very small weapon in their arsenal of dealing with urban revitalization problems. I say that only so that we can have some sense of perspective as we deal with this.

What I see in the drafts of legislation that we now have is a conflict which continues to go on. Is this a jobs bill basically or is it a business and economic development bill basically. And if you look at the way the wrestling goes on and you start arguing one thing then they come back and say no, it's not really this kind of bill anyhow. It's basically the other kind.

The other thing which I think was masked somehow in the discussion Mr. Roemer had in his questioning, is, is this a bill which is directed at bringing large businesses into inner cities. Or is it intended as some people see it to be the kind of bill that will make it possible for new startup companies to move into these zones or indeed, as out in Oakland, I was told, the great fear some people had was that it would wind up largely with companies putting warehouses and other things there until they can get their money out.

I continue persistently to try to push to see if we can support the reworking of this bill. Not only because I think that it gives an opportunity to help central cities in the East, but judging by a question which I heard raised earlier. When I was in California a gentleman who has some connection I think with running the Crown Coach Co., spent a little time fundraising and running a campaign for Mr. Reagan. And one of the things he pointed out is that if he is going to continue to do business in what is an industrial area there with high taxes and other kinds of problems, and if he is not going to lose some of the employees he has had for 20 to 25 years, then something very much like this kind of bill is going to be necessary. I felt he could explain that more easily to the President than I could.

We are suggesting that it's important to look at job training as a correlative principle as you start looking at revitalization of the areas we are talking about. We know as much about CETA, I think, as anyone, and sometimes I think we know too much about CETA because we have studied it for a long time. We've done publications on it which we would be happy to share. But it seems to me that if you don't correct your job training programs, if you don't focus your vocational education programs on some of the ways that are being suggested here you can't succeed. I taught in my earlier years at Hampton Institute in Virginia and my students who were trade school students then would come back and say "Prof, there is no way that the classroom can keep up with the turf." Technology changes much too fast. Industry changes much too fast to use a strictly academic vocational education approach and I think some of the things being suggested here are of importance as you look at CETA and some of the other programs.

We think some of the changes which have taken place since the conference we had on the Kemp-Garcia bill are going to be of benefit to small businesses. The employer tax credit, we'd like to see improved in certain ways which we will draft and send you later. The cash method accounting process—because everybody is not going to have a control data business center in his community.

The 50-percent investor credit. I think it's important too to look at what States are doing; like Connecticut for example. One of its people was talking to us the other day. They moved one of the key problems that has been identified here before, that there's no point in giving tax exemption or depreciation allowances to people who don't own any equipment and are just getting started. They are setting up a $1 million venture capital revolving fund. Had a little experience secondhand at that because we put together a minority contractors assistance program in which the insurance companies and others with help from EDA supplied this revolving loan fund without which the initial capital would not have been available to small businessmen.

They are also giving a $1,000 grant to those zone businesses that will hire and retain employees over and beyond the number that they start with. We think too that the value of some community-based organizations continues to be ignored in the legislation. I am a great believer in the potential of the PIC's but I know very well that when I go to look at some of our affiliates, Jeff Vanderleau for example, in St. Louis, where they have built and rehabbed more housing than the city was able to do on its own. Where the Brown Co. brought a plant in there, there was no vandalism, there was no theft, they had the best record in terms of nonabsenteeism and nontardiness and within 3 years were beginning to show a profit. They were using people who came out of that area. Our Woodlawn organization in Chicago has done much the same thing.

Janis and Opportunity Funding, who were partners of ours in these ventures, have looked at the kinds of capital formation needs which ought to be in the bill and without which we cannot get the smaller businesses in there and we'd like to point out one thing about our insistence on small businesses.

Eight to ten jobs held by minorities are provided by small businesses. Taking UDAG at about the time it was beginning to address itself to some of those problems. I see a great problem occurring when we get a bill which will encourage companies that produce very few new jobs in this country and leave out those that do produce a number of new jobs. Now you can use UDAG for parking lots, anything else you'd like, and it is not required any more that it has any actual incentives for the people there.

There is another problem which I think we might gain something by looking at: The Japanese and German counterparts in terms of the degree to which, for example, you encourage research development and technical assistance to those who are getting started. Whether it is in this bill or not, to cut back on the encouragement of research and development creates a situation in which it's going to be hard for two fellows to get together in a garage and wind up with what Hewlett-Packard became. We can't forever go on having companies buy other companies up and then think that this is the way that this country is going to get itself out of its difficulties.

Finally, if you look at the census, I think you see a portrait of what the future of this country is going to be. In part, what that says is that although it was not reported to the President evidently that black unemployment among youths was higher than it had ever been, the answer given on one program by one of the economic advisers was that we are going to wait until this great surge caused by the economic program takes place in a year or couple of years to kind of deal with that situation.

Like it or not, blacks and Hispanics, many of them quite young, are going either to comprise a large portion of this country's work force in the near future or they are going to be its jobless people, the fodder for whatever kind of problems that any country is likely to have. Anybody who knows me will say although this coalition was formed after the riots in the 1960's, I am not in the business of predicting them because I can't stop them, so no point in my predicting them. I do say that I think rather than throw out CETA or any other job training program, we must modify focus and see how it can be helpful. Although there are no residency requirements, I think in the new EZ bill it is still true that if some of the people from the adjacent areas are not permitted to get in either by training and getting some jobs there or being among the entrepreneurs, we have lost a golden opportunity.

[Mr. Holman's prepared statement follows:]

PREPARED STATEMENT OF M. CARL HOLMAN, PRESIDENT, NATIONAL URBAN COALITION

Good morning, my name is M. Carl Holman and I'm President of the National Urban Coalition. I would like to thank the members of the subcommittee for granting the NUC this opportunity to present its views on small business, urban revitalization and employment problems.

As you may know, the Coalition came into existence in the wake of the riots in the late 1960's, with a convocation of business, labor, city government, minority and community leaders who felt that their joint efforts were necessary if the nation's cities were to be restored to their past vitality. Working with its local affiliates, the

NUC has been actively involved in the struggle to solve the revitalization and employment problems that have plagued our urban centers.

The goals of revitalization and job creation must be seen as correlative principles and not necessarily a cause and effect relationship. Many cities are striving to rebuild their downtown areas. New office buildings for law firms, businesses and corporations cover the landscape. This downtown development has also spurred housing rehabilitation efforts in selected parts of many cities. This revitalization has helped ease the substantial tax base loss occurring in many older cities due to industrial outmigration and changing population patterns. Unfortunately, this revitalization has not succeeded in spurring employment for the cities' unskilled minority and disadvantaged residents. The jobs created by this revitalization have been primarily white collar, professional positions. In addition, the housing rehabilitation has served to displace many poor and elderly city residents, as condo-conversions and rents have skyrocketed. The national August unemployment figures reflect the rampant unemployment problem among minority teenagers, with the official figure now over 50 percent. The dilemma facing us, then, is how to spur revitalization, thereby increasing the tax base and creating jobs for the disadvantaged and minority residents of the inner city. 1980 Census data confirms the fact that minorities and the poor are becoming an ever increasing portion of the population in our urban centers.

Past urban revitalization and employment policies have concentrated on attracting big business and large corporations to urban areas. It is readily apparent that this strategy has not been a rousing success. Recent studies reflect the importance of small businesses, which in the past have so often been neglected by national policymakers. Small businesses, those with less than $5 million in assets, now account for 45 percent of the GNP and 58 percent of the private employment in the U.S. There are now 12 million small businesses, employing 95 million people. Numerous recent reports indicate that small business provides between 75 percent and 95 percent of all new net jobs in this country. It is evident that small business must become an integral part of a comprehensive urban revitalization and employment policy.

TAX BILL

The 1981 tax bill recently signed into law by the President is intended to stimulate business development. Unfortunately, the bill does little to encourage small business growth and development. The tax bill promulgates the policies of the past, with the notion that what is good for big business is good for small business. Examination of the provisions in the tax bill illustrates the emphasis on big business.

One of the major business provisions in the $750 billion tax cut bill is the 10-5-3 approach to accelerated depreciation. A National Tool, Die and Precision Machinery Association (NTDPMA) study indicates that 60 percent of the benefits under 10-5-3 will go to corporations with over $250 million in assets, the largest one-tenth of one percent of American corporations. Only a small percentage of businesses will be able to take advantage of the write-off benefits of 10-5-3.

A representative of the National Small Business Association, testifying on 10-5-3, stated, "It would be difficult to write a tax bill better designed to speed the extinction of small businesses."

Other business related provisions in the tax bill include the reduction of capital gains and corporate tax rates, increasing investment and rehabilitation tax credits, and estate and gift tax reductions. These changes may be of some benefit to small business but the vast majority of beneficiaries will include big business and large corporations.

The tax bill does contain several specific provisions designed to stimulate small business growth and development. These include increasing the number of shareholders for Subchapter S corporations from 15 to 25, simplification of the LIFO accounting method, increasing the amount of earnings a business could accumulate before taxation from $150,000 to $250,000, and extending the Targeted Jobs Tax Credit for one year.

These provisions will be of some use to small businesses but will only marginally decrease the tax payments of small business. Most small businesses have little, if any, profits during their first few years of operation. Because of their high risk, low profit characteristics, tax credits are of little benefit to small business. In light of recent studies reflecting the importance of small business to job creation, the NUC fails to see how the tax bill will generate significant numbers of new jobs, particularly of the kinds of semi-skilled and unskilled jobs that many of our disadvantaged residents so desperately seek.

JOB CREATION

It doesn't make sense to train people for jobs that are not there. All too often, however, employment and training programs and economic development activities are poorly coordinated. The results are not enough jobs for unemployed people who are willing and able to work. What is required is greater coordination between economic and employment development policies and projects. We need a new national employment policy with public and private job creation as its cornerstone, rather than as an incidental adjunct, coordinated with a new economic development policy that explicitly ties its loans, grants and tax incentives to local, regional and national employment needs. Without a major change in national policy, employment programs, even those coordinated with the private sector and economic development agencies, will continue to have primarily an employment redistribution effect, and only marginally an employment generation effect. The result will be a continued high level of unemployment, and the social and economic costs that accompany poverty and wasted human resources.

CETA can react in a timely fashion to unassisted business startups and expansions by maintaining good communications with local employers and Chambers of Commerce. If marketed properly, the training and placement services that CETA offers and the effective subsidy that these services represent can function as a strong incentive for private sector involvement. CETA has a range of tools at its disposal and encounters a range of local and state conditions, each of which requires a different approach. By maintaining a flexible stance toward economic development and a willingness to adapt to specific circumstances, state CETA offices and prime sponsors can maximize their ability to meet the needs of unemployed individuals. If this Congress acts to eliminate all job training functions within CETA, the plight of the unemployed and underemployed in our nation's urban areas will be exacerbated, because the private sector alone simply will not, by their own admission, be able to pick up the slack.

FEDERAL POLICIES AND SMALL BUSINESS

The NUC believes that Congress must begin to establish a concrete formula for encouraging small business starts, growth, expansion and development, especially in urban areas and communities where high unemployment is the norm, not the exception.

Our urban centers face a precarious future. Many are undergoing a devastating fiscal crisis. Outmigration of people and business has resulted in a tremendous loss of many cities' tax base. This revenue loss will be compounded by reductions in the amount of federal and state aid to localities. The net result for city residents possibly will be cuts in public service and/or increases in local taxes, causing an ever greater outmigration and further tax base deterioration. Inner city crime has risen again, particularly property and violent crimes.

The rise in crime is being accompanied by layoffs and hiring freezes in many city police departments due to budgetary constraints. I could spend many hours detailing the ongoing problems of our urban areas, including decaying infrastructure, dilapidated housing, inadequate schools, but in the interest of time I will avoid that detailed description. Suffice to say the situation is a potentially volatile one.

How, and what action can we take to revitalize and create employment opportunities in our cities? Understandably no one program can achieve overnight success, nor serve as the panacea for all the ills plaguing our cities. We must examine those policies that have been successful in the past, and we must scrutinize new ideas and innovations in designing and implementing future programs.

One such idea is the concept of enterprise zones. The concept, proposing to designate specific geographic areas for tax and regulatory relief in an effort to spur economic development and employment opportunities, offers some hope for future revitalization.

The NUC feels that if enterprise zones are to be successful, they must not only target geographic areas, but must also target the incentives offered to those small businesses which are most likely to be successful in creating employment opportunities and spurring economic development, namely small business. In order to do this, enterprise zone legislation must address the impediments currently restraining small business growth, expansion and development.

The various EZ measures pending before Congress each contain some provisions that would generate small business growth. The Kemp-Garcia bill includes: (1) a refundable employee credit equal to 5 percent of his/her wages; (2) an investor credit of 50 percent of the interest earned on loans to zone businesses; (3) cash method accounting for small businesses with gross receipts under $2 million; (4) and the extension of the net operating loss carryover to 20 years. The Rangel bill provides for an employer wage credit on the first $10,000 in wages of 50 percent, 25 percent and 10 percent over the first 3 years, respectively, for all targeted workers. An additional 15 percent credit in each of the 3 years will be available if the targeted worker resides in the zone. Mr. Chairman, your bill would benefit small business by increasing the rehabilitation credit to 25 percent for all non-residential structures and increasing the first year additional depreciation allowance from $10,000 to $40,000. The Heinz-Riegle bill would increase the maximum number of shareholders from 15 to 100 for a Subchapter S corporation. A combination of these provisions would provide a better targeting of incentives to small business, especially if tax credits were made refundable to improve the cash flow of small businesses.

NEIGHBORHOOD ASSISTANCE TAX CREDIT

In addition, four states now allow corporations a credit against their state corporate taxes, if they contribute to CBOs and neighborhood organizations. CBOs use this money to fund revitalization and economic development efforts in their community. The credit benefits the corporation, the CBO and the residents of the community. We encourage Congress to examine the feasibility of enacting this type of incentive at the federal level, thereby assisting revitalization and economic development at the local level.

SMALL BUSINESS

The major problems currently facing small businesses, though, are not sufficiently addressed in any of the EZ bills. Access to start-up capital and low-interest loans are most often cited by small businesses as the major obstacles to their growth, expansion and development. A recent MIT study indicated that 85-90 percent of all small business starts are financed through personal savings. This dependence on personal savings for small business starts eliminates great numbers of potential entrepreneurs from establishing a business, particularly minority and inner city residents who lack adequate personal savings.

Financial lending institutions are another impediment to small business starts. These institutions are often reluctant to make loans to entrepreneurs interested in opening a small business. This is especially true when an entrepreneur is requesting a loan to establish a business within a depressed urban area.

The interest rate differential that financial institutions charge big businesses and small businesses poses another problem. The Small Business National Unity Council states ". . . the major banking institutions of this country are lending money to big business at 4-5 percent below the prime, while charging the small business owners 2-4 percent above the prime. The 6-9 percent loan rate differential places the small business owner in a competitive disadvantage of major proportions, which is often impossible to overcome in the marketplace."

High interest rates are also strangling small businesses. I believe a direct correlation can be drawn between these high interest rates and the rise in unemployment, because small businesses, which should be providing the necessary new jobs, are not able to expand, grow, and develop.

While the enterprise zone legislation can do little directly about high interest rates, it can address the capital formation problem, by enacting provisions specifically designed to encourage small business investment.

In addition to including capital formation provisions, the NUC has some other concerns about EZ. We feel that the success of a zone will be dependent upon cooperation between the private sector, local government, community based organizations, neighborhood groups and the zone residents themselves. We have seen too many urban policy initiatives fail because of the exclusion of CBOs and residents from the decision making process. CBOs, because of their proximity to, and understanding of, the community, have unique characteristics and contacts that should be utilized. We hope that any EZ legislation enacted would mandate a role for CBOs to play in the planning, implementation and development of a zone.

Another problem that must be addressed is intracity relocation of business, from one part of the city to the designated enterprise zone, in order to take advantage of the tax benefits. This intracity relocation would result in a net revenue loss for the city and would probably produce few, if any, net new jobs. One possible solution would be the establishment of a local EZ Advisory Board to monitor business location in the zone. A Board consisting of representatives of the local planning commission, private sector, CBOs, and community residents could foster the necessary dialogue and cooperation needed to oversee zone activities.

The EZ legislation offers an excellent opportunity to focus on the needs of small business. The EZ proposal is the only initiative the Reagan Administration has advanced to revitalize and create jobs in our depressed urban areas. It is the responsibility of Congress to see that this initiative is directed to those businesses that offer the most hope in achieving revitalization and job opportunities, namely small businesses.

STATE EZ BILLS

A large number of states and localities have decided not to wait for enactment of federal EZ legislation and are enacting their own EZ measures. Eight states have now passed some form of EZ legislation. The state of Connecticut has passed legislation that we feel is the best of the lot and could be used as a model bill for other states.

Connecticut has established a $1 million venture capital revolving loan fund to provide low-interest loans to small business. A $1,000 grant will also be given to zone businesses for each additional full-time employee hired. In addition, an employment training voucher system has been established to allow employers to use the states' job training programs by employing the holder of the voucher. Also state corporate income taxes are cut by 50 percent for 10 years, and property assessments on newly constructed and rehabilitated property in a zone will be frozen for seven years. The NUC feels that the Connecticut bill squarely addresses the capital formation, job training, corporate tax, and property tax problems now adversely affecting small businesses. In addition, it provides an incentive for a business to create and expand employment opportunities. We feel that the Connecticut bill would serve as an excellent complement to federal EZ legislation targeted toward small business.

CONCLUSION

Urban revitalization and job creation are two issues that will require a concerted effort by federal, state and local governments if we are to improve our cities, which are the cornerstone of this country's cultural and economic activity. Cooperation between the government, private sector, academics, CBO's and community residents is vital to the success of this revitalization.

We must make use of our resources in an efficient and effective manner. Employment is the key to solving our urban problems Unfortunately, businesses that can provide those jobs have left or are leaving the city in favor of the suburbs. This trend must be reversed. Job training programs that provide marketable working skills must be established. Vocational education programs must be expanded to encompass the teaching of these skills. Adequate incentives must be offered to business to provide on-the-job skill training. Only through gainful employment can inner-city residents achieve self-sufficiency and utilize their talents and capabilities to the betterment of our society.

Thank you.

Mr. NOWAK. Thank you very much. All three of you have been very direct and very precise and to the point and made some very important statements.

Mr. Holman, let me start with you in reverse order here. What have your latest communications been with the administration regarding a pure enterprise zone bill that was talked about?

Mr. HOLMAN. I have submitted a couple of memorandums and the testimony that we had to the HUD task force, but we haven't had a response from the secretary of HUD to date because I don't think he has had a chance to look at it.

We are in continuing communication with Mr. Kemp and I have another meeting set with Mr. Garcia trying to see whether or not we can make additional suggestions of a kind that the business people, the representatives of financial institutions and the economic development people have given us. Some of the points we have come out of that.

Mr. NOWAK. It is my understanding that the administration supposedly is working on this bill or on this concept, as it were. We can use that and to my knowledge they have not really taken a position on any bill that had been put before the Ways and Means or any other committee in this Congress.

Mr. **Holman**. That's true so far as I know.

Mr. **Nowak**. What we're trying to do here is to get the thoughts of many in trying to analyze what a possible bill should look like as we enter the next round of incentives. Talking about the 1982 budget, we are going through the appropriation process now but very shortly, in fact, probably at the same time that we are discussing this program here, they are looking at the 1983 budget. When November and December start to roll around, Congress is then of course going to be looking at the next set of budget figures for the next year and it is critical then that some thought of this is given serious consideration if an urban policy is going to be devised that makes some sense. I think your background and discussion of this subject is very helpful. We look forward to working with the other committees and the other members who have submitted bills to see if we can't bring about a consensus for at least consideration in the 1983 budget because all of this has to be part of that so-called comprehensive strategy that everybody talks about. Nobody has defined it and nobody has put it into bill form where it makes some sense, especially something like Mr. Weiss' perspective here of just training skilled labor. There is nothing out there. You mentioned the PIC's and I was also going to bring that to your attention.

Mr. Weiss said since the CETA people were removed as direct employees, the Private Industrial Council has set up a program training welders, one skilled trade in which there was a shortage. They are in the process of training quite a few in this trade alone. And also over at Comtech the computer analysts, are being trained in the surrounding community in so-called onhands work with city residents to bring up their skill levels so they can actually then go from that training program after 6 months or 1 year, right into a job with the company that trained them. I am wondering if you had the opportunity to talk to Henry Cords about the particular problem in your industry.

Mr. **Weiss**. Well, first of all, the emphasis in the training programs that we have—for instance, I need welders. I hire welders. But what they bring out of the schools is no good to me. I am trying to tell them that we don't need stick welders. We need people that can heliarc weld fine aluminum or stainless steel parts. There are none of these available. We have to train them. They come in hired as welders. They expect to be paid as welders and at first they are useless to us. We have to spend a lot of money to train them. Another thing that is very important today is that we should get people who can maintain all this complicated equipment. We have computerized stamping equipment, machine equipment, but nobody can maintain it. Now, that's a very vital thing today. Programs are fine, but after they get through programing if the thing breaks down there is nobody who can fix it. So I always have to get a man from the factory and that takes 2 weeks. There is something vital that should be taught. In my opinion, vocational schools in the cities should be given prime consideration because if you give these young people something to do with their hands, the dignity of labor will make them different people. Some won't profit from sitting in some academic classroom. Mr. Holman can probably verify that.

Not that I am against academic training, mind you, but there are some people that are simply not motivated that way. Give them something to do, put them into a factory where they live in the everyday world. That's the way I was brought up; I learned; 5 days a week I went to school, 1 day for 4 years and that's my basic training. I had nothing else. With that you can go out in the world and do something.

Mr. **Nowak**. The only so-called onhands or retraining program I am aware of is the PIC program. Perhaps Mr. Rosenow and you could sit down together and see if something more specific could be devised for that industrial problem that you have and perhaps we can do something specific in conjunction with the State of New York. But certainly on a much broader based scale. You know, the vocational schools that are turning out machinists and so forth, will have very little effect, I would think, especially on the new skills that are being developed because the teachers aren't teaching these highly technical skills.

Mr. **Weiss**. Well, the teachers are being put on the retired list by industry at 65. They are out there shriveling away, being old people. That's foolish. We have these guys that are at the peak of their knowledge and they don't teach. That's what we need.

Mr. **Nowak**. I wondered—we have a vote on the House floor. I wonder if you gentlemen would mind, I have a few other questions and Mr. Roemer has a few other questions also that he would like to ask. May I ask you just to sit in recess for 10 minutes and I'll be right back.

Mr. **Weiss**. OK.

Mr. **Nowak**. Thank you very much.

[Recess.]

Mr. **Nowak**. The subcommittee will come to order and continue our questions for our panel. There are many questions that I think could be focused on because of the work that each of the panelists have done in their respective areas.

One of the broad questions we are dealing with here is what type of initiatives are needed. It has been suggested that certainly the tax code as it has been changed has some broad initiatives for the small business community, but we still have testimony that would indicate hopefully we can complement that kind of incentive with more specific things that have been talked about over the last 2 days.

I guess what we are trying to do is fashion the most cost-effective way to use these incentives. One of the ways in which we talked about of course is using the tax code over the overt funding measures that had been used perhaps in the sixties. Now the pendulum has swung around to using the tax code. I don't think we can with absolute certainty say that one is exclusive of the other and we can't look at both to forge the best answer to these questions.

But either way, you have either revenue expenditures or revenue loss, and you still are going to come down to the tough question for the administration to get into, where they fashion these incentives to get the most bang for either the loss of revenue or for the buck that is expended overtly. In that whole context, of course, is where all this discussion is presently centered.

I wonder, Mr. Holman, if you could address yourself to the revenue loss question and if in your view these revenue losses—and I quote that because in many instances I think they're an investment—but there is certainly a revenue shortfall, at least initially in putting these packages together. Without quantitatively giving a ratio of investment to result, do you think that basic decision to put these incentives in place would have a good effect?

It sort of follows the question that Congressman Roemer asked about what programs should be adjusted in putting this whole policy together, an adjusted revenue loss.

Mr. HOLMAN. I know very well that if you start with the notion that you are going to have relatively small numbers of zones the first time around, then the problem isn't as complicated as it otherwise might be. But it is pretty clear, the nature of things being what they are, with the country being so complex, and political pressures being what they are, that everybody will want to be in on the first round one way or the other. It makes a great deal of difference, in places such as London where they have only one zone, and another zone in Wales and so forth where you can more easily gage the success of the program. But with a small number of experimentals to start with, it might not be as easy to do it that way in this country.

To the degree that you increase the number of places that you're giving these kinds of exemptions to, you increase the revenue loss. You had the one time mayor of New Orleans here, but I introduced Mr. Kemp to the present mayor and to the mayor of Oakland, and they were saying, "Will there be a kind of hold-harmless in terms of what we're going to lose in terms of revenues during that particular period?" So everybody wants the zones—and I don't think they worry too much about the revenue loss to the Federal Government—but they're a little concerned about their local revenue loss. That is something that the political people can handle more easily than I. But clearly, the larger the number, the more costly.

In addition, though, it seems to me that it might be possible—and this is dangerous ground as well—to say we will be flexible in the incentives if there is a State that is coming up and saying, "We will assume a part of the revenue loss," in the way, for example, that Connecticut is planning to do. And I think there are three or four other States that are coming up with enabling legislation. So if there is no enabling legislation, if no part of the load is going to be taken by the State itself, then the Federal Government might have some second thoughts in terms of the degree to which it would be generous with its incentives.

I say that's arguing against interests, because some of the States that I know about are going to say, "We have given our last full measure and don't have much more to offer."

Mr. NOWAK. Mr. Rosenow, how about the participation from the State in conjunction with the urban enterprise zone? What is our State doing to try to complement any type of business expansion within the prospective zones now and what do you foresee they could do to complement the program?

Mr. **Rosenow**. I think, unlike a number of other States which have gone ahead and passed bills, New York State has not at this time passed any kind of enterprise zone bill. I think it's a wait-and-see attitude.

However, for businesses that do plan on expanding within the State, the State of New York does have legislation to authorize local governments to provide rather substantial property tax abatement and also franchise tax abatement and some other benefits as well. As a matter of fact, I think a number of the bills passed in some of the other States that I have seen have not even gone as far as the abatement that is available statewide already.

Some of the problems we are trying to wrestle with is if, in fact, cities are going to have to compete for designation, there won't be much left to give away. It's a question I think, in the most distressed area of the county, which might be the city of Buffalo, where we would look to the State to reimburse the city for tax abatement which it would give away in the zone.

I don't see any other way the city could increase public services and have a revenue loss at the same time, especially since balancing the budget is an annual crisis.

Mr. **Nowak**. One of the incentives Mr. Weiss talked about was about the problem of skilled labor and training people. I wonder if your perspective couldn't be not only through the PIC, but also through the community college system, a 2-year growth in that area of education. Could they be more closely tied in with the actual needs of the community, taking advantage perhaps of some of the things Mr. Weiss suggested, as far as having those retired, very highly skilled workers come in and in a cooperative venture provide the kind of training and job opportunity development of those skills for the community, such as Buffalo.

Mr. **Weiss**. Well, Mr. Nowak, we just recently got involved in hiring about six young people just in the last month or so, and they came out of institutions like the Metal Working Institute on Broadway, and then the Moot [phonetic] Training Center in East Aurora, and the Bosis [phonetic] School. Now, these people had a 1,000 hours of exposure to classroom work and working mostly on machine tools, not in our particular field of discipline. But we hired these people because at least they knew what a thousandths of an inch was and what a micrometer was. They could speak our language and read a basic drawing. To us, this is very important.

Now, we are taking these guys at $6 an hour to start. We are putting them next to people that are our top people and who are going to retire. In other words, they just stand there and watch for maybe weeks, help along a little bit here and there, but just to observe what it is we are trying to do.

We are probably a very special sheetmetal firm, not a firm that is usually conceived of, like making ducts and things like that. But we are doing things where five-thousandths is an everyday tolerance to us, you know, and sometimes much closer than that. So we have to train our own people. But if we had a vocational school, for instance, where we could have some of their good students come and work at our place, even part time, and then go back and have them tailor a program that is peculiar to us only, within the broad spectrum of our sheetmetal trade, then we wouldn't have to teach these people the fundamentals of geometry, et cetera. But these are the kinds of skills we are looking for.

Welders, again, as I told you before, we get these fellows and they come out with a stick welder and we can't use them. But we have to then start training our own people from scratch. It's very expensive.

Mr. **Nowak**. Had you had an adequate supply of well-trained people in the past 4 or 5 years, would you have been able to expand your business?

Mr. **Weiss**. Right now I am looking at plans to double our floor space. I could use twice as many people. I am turning work down every day. It hurts me to do that because I remember other times. But we simply are not able to take on orders that we cannot deliver.

Mr. **Nowak**. This is the problem, I think. We have certain skills that aren't being taught or aren't being learned, and as we don't produce the goods and services, they are being produced in other countries and other places where training is perhaps more direct. Yet we have this tremendously high unemployment rate. We have opportunities like in this industry and we are just not producing.

Mr. **Weiss**. That's right. We used to——

Mr. **Nowak**. We could expand the business, and we all cry about the high rate of unemployment.

Mr. **Weiss**. Twenty years ago we used to get our people out of the old aircraft trades—Bell, Curtis and Twin Coach—and they're gone. They're retiring. My oldest and best man is 77 years old. I'm using him for a teacher now. But we have to get going pretty quick or we're going to be down the drain instead of expanding.

If we had more vocational schools in the cities and could get these young people into vocations and then cooperate with industry, we could put them into everyday operations where they see what is being done and where it is used. Get a little pride instilled in these people and they'll be all right.

Mr. **Nowak**. There is no question, especially when you read the statistical information, that some 44 to 45 million workers will be affected in the next 10 to 15 years with the new technologies that are being born and the new skills that have to be learned. The information processing and new technology areas are going to displace or at least affect that kind of numbers of people. So unless we do have the kind of training, first of all, our research and development or technologies won't develop as fast as they would have, and second, of course, you're going to create an unemployment problem because you are not matching the needed skills to training.

Mr. **Weiss**. Sometimes we forget the basics. A craftsman is a craftsman. You can't put this rostrum together with a computer, or this table, and you need somebody with hands and the brains to put it together after the machine makes the different parts. That's what our problem is. We are becoming a service-type industry and we are getting away from manufacturing. It's a big mistake.

Mr. **Nowak**. Mr. Roemer.

Mr. **Roemer**. Yes, I had a question, Mr. Weiss, in your testimony that I was confused about, on page 2 of the copy I have. You said at the top of the page,

> Rather than rely on the fragmented and inadequate manner now employed by individual companies, we should establish a well-organized apprenticeship program for all trades on the Federal level.

Then at the bottom of that same page you say,

> Otherwise, the Government should not be involved, except for easing the reporting requirements now demanded.

Am I getting two different points confused?

Mr. **Weiss**. Well, that is probably confusing. What I am saying is that there should be a natural dedication of policy dedicated to training people in practical trades, a basic framework that could be a Federal framework, and then let the States help through their labor departments. We have in New York State a very good labor department that used to have an apprenticeship program. They don't address themselves to that any more. We used it 20 years ago. That's what I mean, somebody to tell the States that here is a basic framework; why don't you work something out with industry as to your local need. You know, every need is different. What you do in New Orleans or in Buffalo are maybe two different things. I need something and you need something else. But you still have a need to train somebody to do it. That's what I'm talking about.

Mr. **Roemer**. So you don't consider that incompatible at all. You're talking about on the one hand a national framework or policy——

Mr. **Weiss**. Just a policy. The Federal Government beyond that shouldn't even administer it. Just to tell the States "Here's a framework that we think is necessary to maintain the skills in this country." Because if we keep on going the way we are, we are never going to get off the ground in a national emergency, I'll tell you right now.

Mr. **Roemer**. And as part of that specific framework, you would have such things as incentives to allow senior members of the work force, say people who have already retired but still have the skills—once you learn how to ride the horse, you can always ride it—to encourage them to teach others and to participate.

Mr. **Weiss**. Exactly. They're at the top of their skill and they are being thrown on the scrap heap. They're retired and they're miserable, or most of them are.

Mr. **Roemer**. Very good. I thank you for your testimony and——

Mr. **Nowak**. If I may add something, Buddy. We have to my knowledge a SCORE organization of senior management people that go in and try to aid small businessmen. I don't know how active it is, Charlie, in western New York or in other parts of the country. Yet we don't have an analogous group of volunteers. Now, maybe we can find incentives, and certainly social security should not be affected by that participation. Perhaps an analogous association of skilled people could be put together which would serve this very purpose that SCORE is serving to aid small businessmen.

Mr. **Weiss**. These people should teach in the vocational schools. That's where they should teach, to send people to industry who know what they're doing and have the basics. They should be in vocational schools as teachers.

Mr. **Nowak**. Thank you.

Mr. **Roemer**. Thank you.

Moving on to Mr. Rosenow, if I could, it was fascinating testimony. I want to congratulate you on it. It was really excellent.

There was a part in there that particularly intrigued me, the fundamental questions we might be asking of one another and of this country. Specifically on the fourth page of your testimony you say, "Finally, the economic development assistance should be targeted to basic industries whenever possible so that permanent employment is created and productivity increased."

If you don't mind, for the record, I would like you to define what you consider a basic industry as opposed to what is not, and what you mean by that paragraph.

Mr. Rosenow. I think in general, from a national perspective, basic industry would differ. I'll get into that in a moment.

But that really comes out of our local strategy. The first thing we did was to try and identify which industries would profit in the long term from expanding in Buffalo. If we were moving away from a heavy industry base, we would like to target our efforts. We centered our attention on manufacturing, that manufacturing that services a regional, national, or international market in bringing dollars into the community. Whereas a fast food restaurant or a dry cleaners or a mom and pop store really is dependent on those basic industries.

So in terms of the title IX grant that we received and set up the revolving loan fund on, we limit our fund to manufacturing companies only, and the fund is also targeted to a set of those manufacturing companies that our studies have shown would have the best chance of succeeding.

I think the objectives of my board are to try and reduce the dependence not only of the municipal government but of all individuals and outside government help over a longer period of time. It can't really be done in 1 year or in 2 years. And also, with a very limited amount of funds, we think we can get the maximum return.

Now, having said that, I'm aware there are areas of the country that don't thrive on manufacturing and might thrive on tourism or some other industry. That would really be up to those local areas to determine which ones are their basic industries.

Mr. Roemer. I'm confused a little bit with some other testimony that you gave, and Mr. Holman and others, that the backbone of net job creation in this country is small business. Now, is that incompatible with your desire—speaking of Buffalo or anywhere else in this country—to isolate targets and put the emphasis on basic industry, which tends to be larger in size than the service industry or small business.

Is that incompatible and is that a decision that we need to grapple with in this legislation?

Mr. Rosenow. I see what you're getting at. I think that's another question probably for another committee, since this is the Small Business Committee. But I think there are some legitimate questions raised. For example, in our study of the local steel industry, which we contracted out to a group from MIT, part of the answer they came back with is there is some basic question as to whether the United States wants a steel industry at all in 20 years. We can't solve that on a local level. That really has to be some kind of debate that is carried on on a nationwide basis.

Within the constraints that we can effect, we mean basic to be those activities that are basic to the local economy, not necessarily to the Nation, such as steel or coal mining or food or other basic industries of that nature, there is a distinction of terms here. We found, for example, that the number of small manufacturing companies has increased in the country over the last 3 or 4 years, away from the larger plants.

Mr. **Roemer**. I don't want to be repetitive, and it is perhaps a difference in terms, but it is pretty important to understand what that difference is.

I mean, I take your proposal quite seriously, and I'm going to look at it and hopefully learn from it. It seemed the key paragraph there was your advice to us that the economic development assistance should be targeted to basic industry. And as I hear you now, you are saying that these are industries somehow indigenous to a local area, rather than basic to the national economy. Is that right?

Mr. **Rosenow**. Well, I am saying don't confuse the term I used "basic" with large and small. I would say, in terms of the point I am trying to make, that the benefits as prescribed in the current bill are available across the board from medical service, retail, wholesale, manufacturing. There is no discrimination among businesses of any sort.

If we had the target, we would target to what we call basic. Our definition of basic is basically manufacturing or extractive industries, and a further targeting of small companies within that.

Mr. **Roemer**. Mr. Holman, can you pick up on that?

Mr. **Holman**. I would suggest that if you have a chance you should talk with the people at the Department of Labor and Department of Commerce. I have had some rather chilling discussions with some of them in terms of what the next 10 years would seem to hold. They have some charts showing that the amount of the workforce that is going to be involved in what we used to call basic industries shrinks more and more and more; in which information processing becomes a kind of process by which this country can get ahead and stay ahead; and in which the new genetic industry is going to start with very small groups of people, highly trained. You have high technology, and then you have services. That kind of future, for a person who used to work in a steel mill, and then went back to it after several years and found out that a whole floor which used to be teeming with people now is nothing but the steel running and a guy sitting up there pressing some buttons.

If you have let Japan and Germany get ahead, the other question is whether you can ever catch up, or whether that is what you ought to do.

So when I am talking about small businesses, I am talking about businesses that will be pointed in the direction that the economy of the United States now seems to be heading. That is why I get worried, not just about vocational education, but I get worried about the fact that if we don't have good basic education—and here I am using this in terms of being able to handle numbers, to be able to handle reading and writing—you are going to have a whole group of people who will be disfunctional for the kind of future that America is facing.

Whereas I am very much in favor of the notion of involving people who actually do the work and know the work in teaching it—because you can't imagine the cost of trying to get vocational schools that will be tooled up to change as often as the outer world changes.

I do know that in Philadelphia 10 years we have had an electrical academy run by two companies working with our urban coalition program, and that everybody who comes out of the program gets placed. One of the basic things they have to learn, in addition to work attitudes, is how to handle numbers, how to handle reading and writing. If you try to submit a voucher and you have misspelled everything, you don't get paid and that sort of thing counts.

I do believe that we have to take a hard look at the whole vocational education approach that we have been using. A lot of money still goes into vocational education still in this country, and a lot of it is misdirected. I think that if we are going to gear up to whatever degree the defense industries need, then I hear in Columbus the same thing I am hearing over to my right, which is that a number of people could be useful are older now and there is no next generation coming along that is going to be able to handle that kind of technology.

Mr. **Roemer**. You made a comment in your testimony about—I think it was in regard to Oakland—the city of Oakland—or maybe it was you, Mr. Rosenow, that they were afraid that such EZ zones would be warehouse-oriented rather than—and you asked the fundamental question: Is this designed to produce jobs, to put Americans to work in decent well-paid, economic-freedom type jobs so they could decide their own economic future or whether this was a revitalization program? And I picked up that you saw a difference between those two.

I share the same feeling of a difference, being from Louisiana—and to set the record straight, I am not from New Orleans; I'm from Taylortown, a great town on the north——

Mr. **Holman**. Like the town I'm from in Mississippi.

Mr. **Roemer**. Right.

Well I travel my State, I love my State and travel in it and I see the areas of the Mississippi River that have been revitalized, if you define that by plant after plant. Steel and concrete monuments that don't work people. A $200 million investment that works eight people, that uses the water and the chemicals and the oil and gas to produce some other wealth to be shipped off to a different part of the country.

And that in a sense is revitalization, but it's surely not putting good people to work, and I wonder if you could respond to my same shared feeling that we have to make a decision also——

Mr. **Holman**. Well, I think that that is going to come at you fundamentally in terms of this legislation. Look at what they started out talking about when the bill was first introduced and said only people from the adjacent communities and so-called CETA eligibles would be hired.

First it was going to be 60 percent, then 50 percent, then 40 percent, and now there are drafts (not circulating yet in the Congress) which suggest that you drop altogether any suggestion that there be any requirement that the people who are hired be people who would normally have been called CETA eligible.

So to the degree that that decision gets made, in terms of how many jobs are going to be produced, if the answer is that the important thing is to get the industries in there and to start after 10 years producing some revenues for the city and for the Federal Government, but that we will leave aside this question of job creation, I think then there is going to be a great deal of unhappiness in a number of places.

And not everybody will be able to do what Baltimore I think has rather skillfully done, which is that they have two tracks as it were. They have one set of developments or a development in one area which is largely like some of the UDAG's. That is, in one area office building kinds of complexes, and then over in another area they have a small business kind of approach.

I don't want to make this go on further, but I would like to submit at some point what we were able to do in Oakland in terms of the city center project and around the airport in Newark, to show that you could bring both business and jobs into the new places that you are setting up.

But to do that requires a little more work than some people like to do, because it does take more to bring business people in who do not have a lot of experience, don't know the accountants, the lawyers and all that. And it takes more to bring less well-trained people into those work places.

But if you're not going to provide jobs, then I think revitalization becomes a matter of what you've got showing there physically and what kind of profits you have going on a very small base. But it doesn't answer the job creation question.

Mr. ROEMER. Well if I can conclude, Mr. Chairman, I thank you for that answer, all of you. It was excellent in my opinion, and I look at revitalization without jobs somewhat like I do abstract art—it might interest some, but it has no emotion for me. And I appreciate your testimony.

Mr. NOWAK. Thank you very much.

And let me once again express our thanks for spending the time with us here and submitting the testimony, and hopefully we'll be working on a combination of all these solutions. As you can see from just the brief few hours today, there is a tremendous mixture out there. There are universal kinds of problems, and I really believe that in the past the universality has not been addressed. We have gone after one or another isolated problem, because we haven't been able to address the universality that's in that economy out there in one or another program. It has fallen short, and I can't believe it has because we haven't really coordinated the right mix of kinds of incentives, whether they be tax or whether they be the overt programs that have been talked about.

But I want to thank you for your testimony here, and we are looking forward to sending out a report, and any additional information you feel would be helpful to us we would welcome.

Mr. HOLMAN. Thank you.

PANEL CONSISTING OF VERNON GEORGE, STUART BUTLER, AND LEO FISHMAN

Mr. NOWAK. Our next panel is one that will, I think, look at both sides of this question for us and detail some of the arguments on all sides.

First of all we will have the American Planning Association, and Mr. Vernon George represents that organization; the National Economic Development and Law Center with Mr. Leo Fishman; and Mr. Stuart Butler who represents the Heritage Foundation, which organization has done a lot of work in this area. In fact, I had some staff people attend their hearings and their discussion in Atlanta, Ga., earlier this year on this particular question of incentives and enterprise zones and so forth.

From the Heritage Foundation we have Dr. Stuart Butler who is a policy analyst with the foundation. He received a Ph. D. in economics from the University of Saint Andrews in Scotland and has done extensive work on this issue of urban revitalization.

For the American Planning Association we have Vernon George, who is chairman of the Economic Planning Division. He is also an economist with the consulting firm of Hammer, Siler, George Associates.

And representing the National Economic Development and Law Center is Mr. Leo Fishman, who is an attorney here in Washington, and coordinator nationally for the law center. He has extensive background in private practice and real estate, finance, and has worked along with many community development groups.

Gentlemen, I welcome you all, and I guess we can start with Dr. Butler from the Heritage Foundation and just work across.

TESTIMONY OF STUART M. BUTLER, POLICY ANALYST, THE HERITAGE FOUNDATION

Mr. BUTLER. Thank you very much indeed, Mr. Chairman, and I appreciate the opportunity to testify on this very important area. I did submit a formal statement which I would ask to be entered in the record.

Mr. NOWAK. That will be, without objection.

Mr. BUTLER. I would just like to comment on some of the highlights of that statement, but first I would like to preface my remarks by addressing the very important question that the minority counsel brought up, with regard to what are in a sense our war aims in attempting to revitalize or to alter employment conditions in urban areas.

Coming from an organization, the Heritage Foundation, which is known for its commitment to the market economy, I broadly sympathize with the idea that there are basic changes that should continue and should alter the development of cities and the growth and decline of cities and that we should not in principle attempt to interfere with those.

However, I think the enterprise zone comes from a rather different perspective, namely, the contention that within urban areas, depressed neighborhoods, there are dormant or underutilized factors of production that could be activated brought into life under the right kind of climate.

This, I think, differs very much from the kind of revitalization approaches that many States use, which is in a sense to try and lure activity from somewhere else in order to improve conditions within their particular locations.

The enterprise zone I think is very much a case of trying to expand the economic pie to cause factors of production to become active. It is not an attempt to lure in, to import activity from some other place. I think that's a very important distinction to make. I think if you do that, though, it suggests very strongly that what one should be trying to do is to create new businesses in the sense of new entrepreneurs going into business who otherwise would not have gone into business, rather than even looking at the small business sector as such.

I think if we remember that, some of my remarks may fit in rather more clearly. In looking at the particular role of Government, as I see it, not just within the enterprise zone but in creating small businesses, per se, I think it's very important to look at the nature of the small entrepreneurs who go into business for the first time and the nature of the financing mechanisms they tend to use.

They tend to be very feisty individual people. That's one of the reasons they go into business for themselves rather than to work for somebody else. And that affects their attitudes to the kind of Government programs or assistance that is available.

I think also if you look at the financing involved you do, of course, see a very high proportion of financing for new, small independent businesses coming either from personal savings or from direct loans from friends, relatives, and neighbors, rather than institutional forms of capital. This reflects the high risk involved in such business as much as anything else, and the fact that such businesses are generally lossmaking in the early years before they begin to show a profit.

Given this perspective, I think that that very much indicates the limitations on what Government can do to stimulate that sector, particularly in the city neighborhoods. I think the direct funding programs are necessarily limited because of the characteristics of the people on both sides—the bureau dealing with the very strong individualist.

I think also you have a very important choice problem when you are dealing with direct support of new businesses. How does the person providing the money make the decision between who is going to win and who is going to lose? What is the most appropriate form of assistance and to whom should it go? I think there is unnecessarily a limit on the success of Government agencies in directing finance.

I think also, as has been mentioned earlier, the effectiveness of business tax relief in the sense of depreciation and other types of relief on taxes that a business would otherwise pay. It is again very limited, chiefly because of the fact that most new small businesses do not have much of a tax base to enjoy such tax relief.

I think also if you look at countries that have attempted to stimulate development and enterprise in general by giving very substantial business tax relief you find that there is not a very good correlation between doing this and stimulating a small business sector or the economy as a whole.

I come from a country which has specialized in all kinds of tax relief for businesses, and we have one of the smallest, weakest small business sectors in the entire West. In Britain you can write off new capital equipment in 1 year, you can depreciate half of an industrial building in the first year, but we do not have either a booming economy or a booming small business sector.

And I think that what we find is that if you look at the relationship between the tax system and the success of the small business sector you find that relief on personal taxes and on the returns from investments are a far better way of stimulating the kind of financing necessary for these small businesses.

I think also any kind of investment tax credit approach is limited in what it can do. This is an attractive idea I think on the face of it, but you run immediately into the problem of the choice of support—its being an automatic mechanism. You really provide no market limitation or restriction or allocation mechanism as to where that money goes. This is a case almost of going in a helicopter and distributing the money and hoping that the right people will collect it. I think that is a very limited type of Government assistance.

I think that the bottom line really is that what we can do most effectively to stimulate new business development in the small sector is to aim at trying to encourage investment by small investors in such businesses, and to correct the disincentives that presently exist which encourage small-scale investors to look more at property and safe investments rather than putting their money into what are very high risk types of businesses.

Therefore, the kinds of incentives that are being discussed now before Congress, in terms of looking at trying to give tax relief to the investor in small business loans rather than to the business itself will make much more sense.

I don't believe, basically, that there's a shortage of capital for small businesses. I just believe that the incentives that presently exist in the Tax Code discourage people from putting their money into that area. In other words, it's an allocation problem, not a problem of a total amount of capital available.

I think another point that one has to remember with smaller businesses, of course, is that it's very much a case of meeting the payroll every Friday; that specific costs are of more immediate consideration than sophisticated tax allowances in the long run. Therefore, incentives that will tend to bring down those immediate costs will tend to be more attractive for small business startups.

Particularly looking at payroll taxes and ways of bringing down those costs that are a take from the business, whether or not that business is being profitable or not, makes a lot more sense than some of the more sophisticated types of tax relief.

That, I think, spills over into employment costs per se, as well as regulations that tend to push up the costs of new startups which would fall into that same kind of category, as would property tax relief.

I think addressing those areas is going to be more effective than looking at business taxes, per se.

I would just like to end by touching on one or two other issues of a more specific nature that I think might be of some interest. I think that one thing one has to look at is also a way of widening ownership and sources of individual investment into new small businesses, particularly in depressed areas where I think part of the problem is a lack of ownership of the means of production, not just a case of a lack of jobs.

To stabilize a neighborhood I think it is extremely important to have a wide ownership. I think if you don't do that you also have the problem—the dilemma if you like—that when development does take place, many people who are not immediately involved in this who do not enjoy the jobs right away, find it against their interests. And we find many cases in areas of severe opposition to development taking place coming from local organizations and residents.

For example, the people of Pole Town in Detroit, I don't think they were exactly hysterical in their happiness when General Motors decided to up a factory and change their neighborhood.

You've got to make sure that people within an area are an integral part of the development process and the ownership of that process. In addition to just enjoying jobs, they should be looking at ways of encouraging cooperative types of business ownership, looking at employee stock ownership plans.

It's been suggested that subchapter S of the IRS Code might be used as a way of encouraging more local ownership. I think those kinds of mechanisms are extremely important, as well as just looking at tax incentives or other similar types of areas.

I've mentioned before that I think that regulation is highly significant in these areas. Many of the biggest problems involved with setting up a new business, particularly in city areas and in some of our older cities, involve just getting permission to do so, irrespective of whether the capital is available. It's become almost an art form to try and get through some of the regulations involved.

Finally I would say that there are some very, very important roles for other organizations, the Government and the nonprofit sector particularly, in providing technical assistance to people starting up businesses.

We have no shortage of people with ideas. We have many people who can become businessmen, but they may suffer from the very basic impediments of just not understanding a profit and loss account and some other very basic ideas about business. I think that existing business, the volunteer sector and the Government to some extent can be very effective in overcoming those kinds of needless failures at the early part of the business life.

So I have really addressed mainly the problems of the entrepreneur rather than the training problem, although I touched on the training problem of entrepreneurs. That's really my main specialization, and I think that I would rather like to limit my remarks to that rather than trying to go into areas of job training which I have less onhand knowledge.

Thank you.

[Mr. Butler's prepared statement follows:]

PREPARED STATEMENT OF STUART M. BUTLER, POLICY ANALYST, THE HERITAGE FOUNDATION, WASHINGTON, D.C.

My name is Stuart Butler. As a policy analyst with The Heritage Foundation, I have been examining the nature of small business formation generally, and formations in depressed areas more particularly. In my formal presentation, I would like to concentrate on a discussion of the broad role of government in stimulating the creation of small businesses, rather than more limited issues, such as training programs, infrastructure and similar concerns.

When we analyze the nature of entrepreneurship and new business creation, it is clear why a great many government programs in recent years have not been effective. New, small businesses are not simply tiny versions of large corporations, and the people who run them have very different problems and attitudes. It is evident, for example, that people form their own businesses for "negative" reasons as much as "positive" ones. Frustration with private and public bureaucracies is often a lot more important than the desire for profit. No matter what grants and loans are available, the new entrepreneur has a natural antipathy to the form filing necessary to get them. Unlike the corporate executive, simplicity of business is what really matters to him.

The nature of small business finance provides another key to the best role for government. By far the greatest proportion of start-up capital for small firms comes from what we might call the "informal" capital market—personal savings and loans from friends. In other words, rather than finance from either public or private institutional lenders. There is a good reason for this. New ideas and new businesses are necessarily more risky than old ones, and the informal capital market, appropriately, is based more on faith and personality than on the consideration of rate of return or opportunity cost which characterizes the institutional market.

Because of these factors, direct government assistance to small entrepreneurs, I believe, will never be an effective means of encouraging new formations. When a small entrepreneur sits down with an official from the SBA or a similar agency—or with a bank official for that matter—it is often a "dialog of the deaf." The entrepreneur generally has no track record. He is armed with a bright (or possibly insane) idea and determination; and he is looking for successes, not inspired failures. He has a superior and an annual report to consider. He is expected to distinguish between winners and losers, and yet his own career choice demonstrates that he is unlikely to do that efficiently. If he could do that, he would be making money on the stock market or running his own business, and not working for the government.

Some have argued that we can avoid this choice problem by providing "up front" capital automatically, through refundable investment credits or similar devices. Not only would this be an extremely expensive way of stimulating new formations, however, but it would not even attempt to assess risk in the allocation of public investment. It would be like a bank offering automatic business loans without even the formality of an interview.

If direct government support is not the best form of assistance, then what is? I believe the evidence and concerns expressed by small businessmen indicate that government should seek to construct a climate conducive to risk-taking by investors and entrepreneurs, and downgrade its efforts to assist directly. In particular, government policy should not be based on the assumption that there is some inherent shortage of capital to finance small business. There is not. Rather, small firms are burdened with an incentive structure which encourages potential investors to put their money in housing and other non-productive areas, and discourages them from risking it in new ventures. We do not need new public institutions to supplement the private capital market. If we continue and expand the current Administration's approach of altering the structure of incentives, we will discover there is plenty in America.

There are several elements necessary to correct the balance of incentives that have served to frustrate the small sector, but I will touch briefly only on three. Firstly, broad tax policy. Secondly, regulation. And thirdly, specialized tax incentives.

If we examine tax systems around the world, we find some interesting correlations with business formations and growth. Generally speaking, we discover that those countries which have experienced rapid growth in recent years possess a strong small business sector and yet they do not provide particularly generous tax relief for depreciation or other business costs. The major country that provides the most rapid cost recovery schedule of all is not Japan or West Germany. It is Britain. There a company can write-off new equipment in one year, and depreciate 50 percent of the cost of an industrial building also in one year. Yet Britain's economy is stagnant and crowded with obsolete industries, growing ever larger thanks to government support and internal reinvestment. It is further characterized by one of the weakest small business sectors in the West. Japan and West Germany, on the other hand, have lower depreciation allowances than was the case in the U.S. before the recent tax bill. What we see in countries with a strong new business sector is low marginal income tax rates and low taxes on investment income.

This correlation should not be surprising. Since most new businesses do not tend to show much, if any, taxable profit in their early years, depreciation and similar tax allowances are not very helpful. On the other hand, reduced tax rates on personal and investment income are valuable to those trying to start or finance a small firm. For this reason, I believe that the recently enacted reductions in capital gains tax, personal tax rates, and taxes on investment income will provide a significant boost to new company formations. I doubt, on the other hand, whether the improved depreciation schedule will have a major effect on formations by independent entrepreneurs. Unlike a refundable investment tax credit to businesses, it should also be noted, reducing taxes on investors does not remove the investment selection process of the market—investors are still going to compare alternative opportunities. They are also going to be risking their money, not my tax money; and I must say, I find that a more satisfactory situation.

The importance of deregulation for small firms is understood well enough, I believe, for me to do little more than add my voice to the chorus. The 1980 Regulatory Flexibility Act correctly drew a distinction between the impact of rules on large and small concerns, and a two-tier approach should continue to be central to regulatory policy. I would argue that the 1980 Act should be strengthened, however, to require agencies to provide alternative rules or exemptions for small businesses in depressed neighborhoods. In addition, it should be recognized that much of the red tape impeding small firms emanates from City Hall, rather than Washington. In the case of the Enterprise Zone, the streamlining of such local regulation is seen as an element of the concept.

Let me conclude with a brief discussion of a few particular tax mechanisms which may be seen as additions to the broad strategy of an improved investment and regulatory climate for small business.

EMPLOYMENT TAX CREDITS

If these are to have any real impact on new businesses, they must be simple and refundable, so that they constitute a real reduction in costs to a new business. Refundability should be seen by government not as a direct subsidy, but as a reduction in immediate tax take, enabling the business to become a corporate taxpayer more rapidly.

SUBCHAPTER S TREATMENT

Increasing the number of shareholders under subchapter S from 15 to 100, as proposed by Senators Heinz and Riegle in S. 1240 could well assist the formation of new businesses, particularly in depressed areas. By allowing non-taxpaying firms to pass through credits and allowances to their shareholders, further encouragement to investors would be given by the change. Employee stock ownership plans could add to this by giving employees a stake in the success of a firm.

TARGETED INVESTOR TAX ALLOWANCES

The Kemp-Garcia Enterprise Zone bill breaks important ground in providing for a 50 percent allowance against tax for business income from certain businesses in depressed areas. The British are also developing a plan to allow tax relief for investments of up to $20,000 in a new, small business in certain areas. Each of these mechanisms is worthy of consideration as part of an incentive program to stimulate investment in small firms generally.

Mr. NOWAK. Thank you very much.

We will wait for the other two before asking questions.

Mr. Fishman, would you like to present your testimony.

TESTIMONY OF LEO FISHMAN, ATTORNEY, WASHINGTON, D.C., REPRESENTING THE NATIONAL ECONOMIC DEVELOPMENT AND LAW CENTER

Mr. FISHMAN. Thank you, Mr. Chairman.

Having submitted testimony in writing, I wonder if it would be appropriate if I could just summarize as we go along.

Mr. **Nowak**. Yes. We'll have all of your prepared statement inserted in the record in full, and you may go ahead and summarize and we'll get into the colloquies.

Mr. **Fishman**. Thank you very much.

I work for the National Economic Development and Law Center, and for 12 years this organization has represented community-based organizations which carry out economic development activity.

Among the services we provide are legal, technical assistance, training and a variety of other forms of assistance. The observations I would like to offer stem by and large from this experience and from the experience of the clients.

We certainly share the commitment that a healthy and growing small business is absolutely necessary to the revitalization of distressed areas, and we share that to the extent that we are firmly behind a positive Federal role in bringing this about.

Unfortunately, in coming here today I did not bring a model or a single strategy to recommend as being the answer to all of our problems, and I wish I could have. The problems, as you know, are different from Appalachia to northern Vermont to California or what-have-you. Essentially almost in each locale we are confronted with a set of unique circumstances that breed distressed areas and that cause the problems with which we like to contend.

And as we might suspect, in developing solutions to these problems one needs almost the same flexibility, the same facets in the methods of intervention and the techniques that you use that corresponds to the existence of the very problems themselves.

We find, for example then, that in working on an Indian reservation there are some techniques that we use that are usable in cities—that the groups can use—but most of the experience, of course, is totally different. In fact, even in neighborhoods in the same city we are confronted with a need for mixed forms of intervention.

Above all, in the need for a multiple strategy we've got to keep in mind that you have to be flexible. There are collections of techniques and it's almost a custom blend that has to be used in each community.

And when we look at something like enterprise zones as a concept being introduced into development discussions and into the various debates on how to revitalize small business we have a little bit of uneasiness. Right now enterprise zones dominate the discussion.

You can't go anywhere without contending with the concept and the unfortunate thing is that it excludes evaluations of existing programs, it excludes discussions of other techniques and strategies and it imposes itself to the point of almost eliminating what our objectives are, and instead we end up just considering this program itself.

When we look at the concept we find that there are some very positive characteristics.

First, it's targeted. What everyone is talking about seems to be directed toward distressed areas. It impacts. It is intended to meet those areas that have a measured and discernible need. And that in itself differs the program from others, and it's a very good factor.

Second, among the bills that have been introduced, there is an element of competition. Not every community can have an enterprise zone. And this responds to the problem because quite frankly not every community or city or State can put together the necessary leadership commitment and the ability to manage or whatever else it might take in order to carry out a successful program.

Theoretically, any sort of competitive process will allow those who can perform to come through and perhaps avail themselves of the program. It's a little bit harsh, but I think that experiences of other programs indicate that this might be a necessity.

On the negative side, two things. First, we can't see at the moment the significance of tax incentives, and in our experience we don't consider that the level of taxation is a very important factor among other factors in influencing whether or not someone goes in a business or whether or not a particular business decides to locate in areas. It's not that these have no implications or no relevance whatsoever. It is that among other factors they are minimal.

I don't want to play down or mislead you about the effective tax incentives, the credits, or any tax reduction. It's not that we would disparage that system or that—it's simply that we don't know, especially in the light of new tax legislation. We are not sure whether or not these incentives are sufficient to cause any change in investment behavior. And this concerns us.

In a skeptical way we wonder whether or not the enterprise zones as a concept are merely collections of strategies that correspond to the current philosophy in the political system. It's one thing to go out and say, "Hey, we've got some problems in distressed areas; let's see what we've got and what is needed." It's quite something else to back off from the problem and say a lowered profile for Federal Government or supply side approach is the only area in which dialog, discussion, or suggestion is permissible.

I am somewhat uneasy about that.

I think, too, there is an irony of proposing any new concept that at the same we witness that other programs are being either closed out or closed down because of budget cuts. It just seems that there is a real inconsistency in the approach to distressed areas.

One program that we are quite familiar with is the Community Development Corporation program, operated by the Community Services Administration and funded under title VII of the Economic Opportunity Act.

Title VII will be repealed effective on September 30, 1981, and the Community Services Administration will no longer be in existence. These programs have had some success increasing small business, specifically in creating jobs, employment and ownership opportunities in distressed areas.

This program which is no longer going to be in existence shares the same objectives as enterprise zones and a number of other subjects which we are discussing.

I don't say that this program is the answer; it is simply one tool, as enterprise zones can be a tool, as labor surplus areas for directing small business contracts emanating from the Federal Government might be a tool, as UDAG's are a tool, and so on and so forth.

Within each of these programs there are evidences of success and also evidences of failure, and I think it's very important that we look at these programs to see just what it is they can do and not just make hasty decisions or analyses on the basis of what happens to be trendy at the moment.

The community-based economic development program, the CDC, is a logical supporting mechanism, for example, for enterprise zones. A CDC can provide managerial planning, coordinating assistance and what-have-you. Moreover, it really provides an entry into the community itself. It is a device whereby the community, for example, can monitor the development of the zones.

So it has two purposes with relation to the concept. One as a participant and manager, and the second, of course, more as a force of gaining acceptability for the program.

I guess the conclusion is that I still feel that we need a flexible approach, that we need multiple programs, and that existing programs even under cutback budgets are to be examined.

I was very much interested in the earlier question about what programs are good and what programs are bad. I am getting away from what I submitted in writing here, and if I may I'd just like to offer an observation.

There are communities that can take bad programs and make them work effectively, and there are other communities that can take perfect programs—such as, well—there are other communities that can't assemble a peanut butter sandwich. And that applies to States; it applies to cities; it applies to the Community Development Corporations and other groups we represent.

The difficulty is—and it's a dilemma of our political process—that if you are going to pass legislation with broad applicability you need 50 percent plus one vote and you need a broad impact for any form of Federal intervention. You've got to spread yourself.

When you write community development block grant legislation you've got a formula that gets dollars everywhere, and if you do that you get the support of the cities and you can pass that program.

But what about the communities, the cities that can't use that money effectively? And this is the dilemma. In order to put a program into existence I think there has to be a point of tolerance and the question is how do you play this dynamic and where do you stop making decisions?

I think we are always going to have bad programs if we have broad programs.

If we have narrow scopes of intervention then perhaps some of the waste can be avoided.

And whether those two can ever fit together I really don't know.

Thank you very much.

[Mr. Fishman's prepared statement follows:]

Prepared Statement of Leo Fishman, Attorney and Washington Coordinator, National Economic Development and Law Center

Good morning, Mr. Chairman. I am Leo Fishman, at attorney and Washington Coordinator for the National Economic Development and Law Center, a nonprofit public purpose organization headquartered in Berkeley, California. For twelve years, the Law Center has provided legal services, training, planning and project development assistance to a wide range or urban and rural community organizations throughout the United States. We have also advised units of federal, state, and local government on programs and issues of public policy, and we have worked with private business to promote public-private collaboration in community and economic development.

Most of our clients conduct their business in distressed communities, that is, areas or neighborhoods with declining or minimal levels of economic activity, with large populations of low-income individuals and families, and with intolerably high percentages of residents suffering from chronic and persistent unemployment. A substantial number of these organizations are operated by Black, Hispanic, Native American, and other minorities. Generally, the formation of these groups reflects a self-help initiative to gain control over a harsh economic environment. Specifically, their objectives are the creation and development of employment, income, and ownership opportunity for the residents of their communities.

Obviously, a federal policy nurturing and developing a healthy, expanding small business community is essential if our clients are to be successful. And we commend and support the efforts of this Subcommittee as it explores problems of long-term economic deterioration by focusing on the need to revitalize small business. We appreciate the opportunity to testify, and we hope that our observations are useful.

In formulating a policy for federal action, there is no model nor is there a single strategy to be applied universally to overcome problems of economic deterioration. To improve the climate for small business, we have to acknowledge that the nation is divided into a multitude of environments. Examining the availability of capital, the characteristics of the labor market, the patterns of established commerce and industry, and diverse cost factors for enterprise development indicate substantial differences between urban and rural, from region to region, and even among neighborhoods of the same city.

Moreover, there are significant differences in the capabilities of institutions, both public and private. Among classifications such as states, cities, development districts, and community development corporations, not all of the members are alike; they do not deliver a uniform level of performance. Thus it becomes wasteful for policy to assign an exclusive role to cities, for example, if, in certain stances, a city lacks commitment or the ability to develop resources for getting the job done.

A successful policy, therefore, may have to present a mix of strategies within a highly flexible framework. The need for capital might be met by a Small Business Investment Corporatin (SBIC) or by a "503 local development corporation;" quality of the work force can be upgraded with CETA funds; physical infrastructure can be improved with local money supplemented by support from the Title I program of EDA. But these programs have become increasingly obscure under the recent wave of budget cuts. In fact, it is a harsh irony that funds to combat economic deterioration become scarce as the problem itself intensifies.

Against this backdrop, the concept of Enterprise Zones emerges as both attractive and frustrating. It has become the dominant subject in discussions of policy to revitalize small business in distressed areas. Its presence virtually excludes the contemplation of other strategies necessary for coping with the diverse nature of economic problems. At least four comprehensive bills have been introduced to the House and Senate including the Enterprise Development Act (H.R. 2965) authored by the Chairman of this Subcommittee. Several states and local governments have considered parallel measures, and Connecticut has already enacted its own version. While the Administration has not yet taken a formal position, individuals within certain departments and agencies are actively studying the Enterprise Zone. In short, for policy makers, it has become the only game in town.

In general, the concept has three appealing elements. First, it is sharply focused on areas of need in the inner city. Among the various criteria for Zone selection, both the physical needs and the personal characteristics can be taken into account. Second, the program itself appears to be flexible. To the extent that other strategies can be developed with local resources, the city or community can blend its own mix to meet its unique needs. Third, eligibility for continued participation can influence the local commitment and the ability to carry out the program successfully. Performance contracting, an issue in various policy discussions, may be a positive inducement for progress.

At the same time, the Enterprise Zone presents several uncertainties. There is no evidence nor even a strong suspicion that a series of tax credits and income exemptions will provide sufficient incentive for small business to locate or expand in distressed areas. Moreover, in light of recent corporate tax cuts, the incentive has been severely reduced. Of all the factors determining the site of an economic venture, the level of taxation has never been that important. Another imponderable is the effect of a jobs tax credit on the quality and supply of labor. A location decision is more often made on the basis of what is there now rather than what can be developed in the future in terms of the skill of the worker. For small business, particularly, the ability to adjust to the work force is costly and cumbersome.

The concept of Enterprise Zones, based almost entirely on the provision of tax incentives, is limiting. Where the need for direct capital injection is absolutely required, the program is inflexible and unresponsive. The political influence of supply side economics and a severely reduced role for the federal government have placed the program in an internal inconsistency. On the one hand, there is a manifest willingness to work with problems of distressed areas. On the other hand, there is a careful avoidance of developing and using the strategies which are unacceptable in the current political climate. The horse, therefore, has been hobbled, and it can't run.

The problems of distressed communities cannot be dealt with entirely by a series of tax incentives. Proponents of Enterprise Zones acknowledge the need for other programs and strategies as an integral part of this effort. Yet the wave of budget cuts has severely reduced the scope of these related efforts. Consequently, we seem to be flailing in a piecemeal environment without movement toward a flexible and comprehensive policy.

One of the client groups with which the Law Center has worked is the community development corporation, ("CDC"). And these organizations, if actively involved, can play a key role in an Enterprize Zone program.

CDCs operate in impacted or distressed areas, that is, neighborhoods and communities experiencing blight, high unemployment, low economic vitality, and familiar characteristics. Through self-help and the mobilization of resources, the CDC hopes to develop and operate a program to improve the quality of life. A healthy small business environment, as noted earlier, is a key element of this effort. CDCs have functioned as developer, entrepreneur, lender, investor, packager, and so forth—they attempt to meet the unique needs of their communities.

Generally, a CDC is a nonprofit organization, (grant eligible), governed by a broad based board of community members. Business, government, and residents of the area served are represented on the board. The CDC usually assumes responsibility for planning and program development, and it carries out specific projects through wholly or partially owned subsidiaries, or through investment agreements with affiliates or independent companies. Again, the pattern evolves to meet the uniqueness of the area. All in all, there may be as many as four hundred CDCs throughout the United States, supported in a variety of ways and having widely different experiences in terms of success and failure. For these organizations, there is no precise model or uniform description of activity.

Most significant, however, are the thirty-five (35) CDCs which have received substantial funding support under Title VII of the Economic Opportunity Act. According to the Community Services Administration, this relatively small demonstration program has created more than 10,000 jobs since its inception in 1967. Moreover, with its unique ability to deploy grant funds as equity capital rather than loan money, it has enabled the local projects to attract substantial amounts of private money. Among the CDCs, several programs are noteworthy:

Bedford-Stuyvesant Restoration Corporation, (Brooklyn, New York), has develped a $7 million commercial center housing 30 businesses and employing 270 people; it induced IBM to locate a plant in the area creating 400 jobs; it has also conducted an extensive housing program.

Denver Community Development Corporation, (Denver, Colorado), has invested in a number of small businesses including two markets, a bakery, a yogurt manufacturer, and a down-wear manufacturer; it now plans to develop 14 acres of industrial property.

Kentucky Highlands Investment Corporation, (rural, southeastern Kentucky) has invested in 11 business ventures aggregating $36.9 million in gross sales and employing 413 persons, of whom a majority had been drawn from welfare roles.

Delta Foundation, (Mississippi Delta Region) has developed three divisions of small manufacturing companies: "Apparel" employs 300 persons in making blue jeans and other trousers; "Metals," with gross sales of $7 million, also employs 300 persons in a variety of economic ventures; "Electronic" makes switches and relays employing 50 persons.

The sponsor and principal funding source for the Title VII CDCs is the Community Services Administration, and as you know, on September 30, 1981, the Economic Opportunity Act will be repealed and the Community Services Administration will be abolished. The CDCs themselves will become eligible for funding under the "Community Economic Development Act of 1981," a program to be operated only if funds are appropriated, and only if the Secretary of Health and Human Services exercises his discretion to do so.

CDCs, in turn, could render valuable assistance to the development of Enterprise Zones. They have an established presence in their communities, and they share the common goal of fostering economic improvement. CDC experience in job development and in all facets of small business promotion could be invaluable. Specifically, a CDC can manage a Zone, plan, marshal resources, coordinate various programs and strategies, and do whatever else that becomes necessary. Equally important is the fact that, as community groups, they can buy acceptance in the neighborhoods and provide a unique insight into the problems under attack.

In its assessment of the role of small business as a tool for revitalizing urban distressed areas, we urge that the Committee be mindful of the following:

The problems of the cities are diverse in nature, and their solutions require a flexible mix of strategy;

Some programs, such as the community development corporations, have gained a measure of achievement;

To encourage the development of Enterprise Zones is totally and fatally inconsistent with budget cutbacks in programs with similar objectives.

Our problems are severe, and they may be worsening. We cannot afford to rely on untested, single factor solutions, and the federal government cannot backtrack on its commitments.

Mr. **Nowak**. Thank you very much.

We have as our last panelist from the American Planning Association, Vernon George.

TESTIMONY OF VERNON E. GEORGE, CHAIRMAN, ECONOMIC DEVELOPMENT DIVISION, AMERICAN PLANNING ASSOCIATION

Mr. **George**. Thank you, Mr. Chairman, Congressman Roemer, and staff. I, like the others, have prepared remarks that attempt to address some specific provisions of the various bills, and I would rather like to highlight a couple points—some of which may be in my prepared statement and some of which may respond to questions I've heard asked today.

There certainly is a need for comprehensive legislation or comprehensive approaches, and I want to get back to that in just a while, but I want to talk first about what I would call leverage. As we look around us today there is an old saw that when we fully understand the question we are very close to a solution, and as a consultant of many years experience I tend to agree with that in many cases. But I think today there is an exception to that. I think there is a problem which is the problem in business expansion and job creation and that's the availability of money. We are pretty clear about it and we haven't the slightest idea what to do about it.

In the old days there used to be a concern with what we might call equity capital—that's seed capital that you and I have to have in our bank accounts in order to think about getting started. That's still a problem, but I really find in our business—and we are investment advisers to both public and private clients—that there is plenty of capital around. There is capital willing to invest in—I almost said chase—ideas that have a relatively medium probability of success on the likelihood that the profitability for those who strike home is very, very great and that 1-out-of-4, 1-out-of-6, 1-out-of-10 ratio is adequate.

We have talked today about the distinction between large business and small starting business and we've talked about the difference between area revitalization and job creation.

Dealing first with the former, tax benefits are of little value to a business that is starting out. I have always said if I have to have problems I would prefer to have tax problems. And that's because in order to have tax problems you have to have generated some substantial income and therefore have the problem of sheltering or paying a good part to the State, Federal, and local governments. That is a problem, but it's a problem that comes from an opportunity and a success.

That's not where the small business is at and is going to be. The small business, because of the risk characteristics of its business, is unable to get the money, but also has trouble financing because of the cost of the money.

I have several small businesses, one a consulting firm, one a firm that makes and markets furniture and other high design merchandise, and a third that's in the industrial park development field. In all cases we don't have a demand problem and we hope we don't have a great management problem. But we do have a capital availability problem. It's like upwards of 25 percent a year. In our own retail business, in order to get just a 15-percent return on sales, which kind of makes it worth expanding in that direction, even with an inventory turn of four times, we have to get a profit of from 20 percent to 25 percent. That's extremely difficult to do except in the very high-flying, high-technology, advance marketing kinds of areas. So, even when money is available to us if we have to pay a prime plus 3- or 4- or 5-type rate it's almost not worth our doing although our business in all cases has been in operation 10 to 20 years.

We have a situation now where we have a corporation that makes furniture, it wholesales furniture to retailers and retails it. All three of those businesses are intensive in their creation of the kind of jobs that we are most concerned about here today. We have very substantial pent up demand in all those sectors, particularly the manufacturing wholesale, but we have done an internal analysis that shows our interest cost to be twice what was budgeted last year and have concluded that we are best off not to accommodate the demand and generate the jobs that are available.

I'll not say that there are a very broad range of programs required, but we should try to get the greatest leverage for the public dollar. I give that as background because I think that we would be focused very quickly if we interviewed the Dow Jones firms or if we interviewed a sampling of businesses in Washington or Philadelphia or Buffalo or New Orleans on debt availability for working capital, for capital expansion, for all uses, not just equity capital. I believe that can be raised in almost any community for a good idea and by someone who comes on as having basic business sense. But debt capital is what is needed.

It seems to me if you are giving tax breaks don't give them to me in my business. I have to earn the profit first. But give them to the financial institutions or in some way participate in lowering a prime-plus-2 or 3 or 4, which is almost prohibitive to an interest rate that I can live with.

Now that's not to say, Congressman, that the other provisions of your bill are not essential. And it's not to say that the provisions of some of the other bills are not essential. I think there is the danger that has been mentioned by my copanelists that people are tending to see the enterprise zone as the only game in town, and so they are heaping a lot of responsibility on top of it that I'm not sure that it intended to take on. And I think that relates to a second point that I want to make.

But the first point is:

If we are giving grants they should be filling that interest gap; if we are giving tax breaks we need to somehow subsidize the interest and make the interest from financial resources that go to small or large businesses that create the kinds of jobs we want created, make that tax free for the first 5 years. Or a 75-percent tax break. Because the real log jam, the stone that's lying at the mouth of the funnel, is in fact the availability of that capital. There is no need for tax writeoffs and tax deductions unless the capital to expand and produce the profit which therefore gets sheltered is available.

The second point that I would like to make relates to a question that Congressman Roemer has rather persistently aimed at all of us who were talking about the good life, and that is, can we be specific? And I feel that there is truth in the adage that cities with good development management staffs are able to use most programs. In fact, they end up rewriting regulations, and redefining the management system for the Federal agencies. I think that's the key. I think there is a great need to improve the quality of the management of these programs at the Federal level. And I think when we talk about improving programs, it's difficult to talk about that, though, legislatively, and even administratively. It's much easier to say, "Do we need that program? Let's kill EDA."

I think the EDA programs had some rather specific weaknesses and rather major weaknesses. I don't know whether the weakness was the purpose of making loans or making grants for infrastructure improvements as much as the time required to prepare the OEDP. Now I am not a pro-OEDP person so I won't say anything more about it except anything that thick can't be good.

That's a management problem. Local communities formed committees, invested a lot of staff time to produce something that was largely statistical. It told where you were 30 years ago, 20 years ago, 10 years ago, and in other words, you end up with some pages where you try to set priorities.

But it's extremely important that you all have those figures, and I know you in a way are like a board of directors. I sit on just a couple boards of directors and it drives me absolutely batty because management comes to me and tells me what they've done and tells me what they're going to do and shows me the data that supports what they've done and what they're going to do. And that's not anywhere near the information I need, but unless I can take a day off each week and go out and visit HUD and visit EDA I don't have all the data that I might have as a board of directors member.

We need an overall effort to manage the urban problem. Should there be four or five departments that have urban programs that are available to fund the same project? All have regional offices; all have approval processes; all have applications. For some reason even though it's been tried in the past to make those single applications, it hasn't worked out. Remember the old integrated grant management? Somehow that became a new layer of management.

So that there is a very low bang for the buck within the program dollars spent, which relates less to: Do we need job training, or do we need public works grants, or do we need tax writeoffs, or as I am holding, do we need interest subsidies; and more a matter of: Do we need an efficient management structure to utilize whatever resources are going to be available, whether they are much less, the same, or much more than we have had in the past?

Let me comment only on one other point briefly, and that relates to the geographic specificity of what we are talking about. It seems to me that to the extent that we feel that economic well-being or the general well-being has a strong relationship to economic well-being—and that that is very much keyed to jobs—I wonder if it's so important that we have boundaries for the zone rather than criteria for the business. I wonder if we can decide what we want the development process to do—whether we want to generate jobs, real estate tax revenue, inventory tax revenue, total tax revenue, direct and indirect jobs. That criteria is output oriented, and I believe is a viable management concept.

I would hold that relative revitalization is a much less clear management concept and makes it much more difficult to evaluate the effectiveness with which the various Federal agencies are achieving your mandate to take the dollars appropriated and create jobs and economic well-being. It needs to become much more output-oriented. When they come back to you it should be almost totally output-oriented. Not how many people we have and how many we need, but how many jobs we created, how much tax revenue we created, and what other measures of positive impact were your aims in setting up the programs.

Thank you.

[Mr. George's prepared statement follows:]

Prepared Statement of Vernon E. George, AICP, Chairman, Economic Development Division, American Planning Association

EXECUTIVE SUMMARY

The American Planning Association (APA), a national organization of 21,000 members, including city and regional planners, elected and appointed officials, professional practitioners, educators and interested citizens, appreciates the opportunity to present the following comments on the subject of Job Creation and the Revitalization of Small Business and on H.R. 2965, the "Enterprise Development Act of 1981."

APA believes that increasing the availability of debt capital for operations and capital expansion and reducing the interest cost of capital to small businesses is of the highest priority if these businesses are to effectively create jobs. APA recommends that legislative solutions focus on this issue in addition to tax credits and other incentives for small businesses in such worthwhile legislation as H.R. 2965

In addition, APA wishes to make the following comments on the bill:

APA supports the requirement for planning and urges that this planning include the evaluation of economic development options that will generate the most positive impact on jobs and other benefits and the adoption by localities annually. This planning should include a set of priorities among potential candidate businesses and other development opportunities.

APA supports the requirements that the Secretary of Commerce coordinate programs under this bill with those of other related Federal agencies and the coordination requirements with local governments for maximum "return on investment."

APA suggests that an effective set of funding guidelines be established at the very beginning of the program to minimize the need for costly and extensive reporting and feedback procedures.

APA questions the need for restricting incentives to be provided under this bill to businesses in geographically defined "redevelopment areas," as contrasted to businesses which will best leverage benefits under the bill, no matter where they are located.

APA commends the bill's emphasis on those urban centers which without such Federal assistance are not succeeding in generating an adequate supply of jobs.

My name is Vernon George. I am Executive Vice President of the urban economic consulting firm of Hammer, Siler, George Associates with offices in Washington, Atlanta, Orlando and Denver. In my 20 plus years in the urban development field, I have worked on the staffs of planning and development agencies at the city, county, state and Federal level and have completed consulting assignments in cities throughout the United States. I am a member of the American Institute of Certified Planners and the American Planning Association and was recently elected head of its Economic Development Division.

I also have a personal interest in small business and can speak from firsthand experience. My personal business interest include not only my firm, a corporation with billings in the $2 to $3 million range, but also a diversified manufacturing, wholesale and retail operation with seven retail stores in two large cities and manufacturing operation in two states.

The organization I represent today, the American Planning Association, is a national organization of 21,000 members including city and regional planners, elected and appointed officials at all levels of government, professional practitioners, educators, interested citizens and students. Our membership belongs to 46 Chapters covering virtually every state and Congressional district. The Association's primary objective is to advance the art and science of planning for the unified development of communities, cities, regions, states and the nation. Within APA, the umbrella organization, is the American Institute of Certified Planners, which focuses on professional development and whose members are distinguished by having met certain educational and experience requirements and have successfully completed an examination on planning principles and practice.

Planners have moved in their careers over the years more and more into the business and economic development area. Planners have retained their established role in overall development strategy making. In addition, they have enriched their contribution to the overall economic development process by taking on the additional role of packaging specific projects and assisting businesses. Our members think of this as an interactive process between the public and private sectors. Specific business assistance accelerates the implementation of the strategy and provides important insights for making the strategy more effective.

The very substantial experiences of our members on the economic development "firing line" make us very appreciative of the opportunity to provide our views on the subject of Job Creation and the Revitalization of Small Business and on H.R. 2965. We respectfully request that the complete text of our prepared statement be included in the hearing record.

Because of their dual responsibilities in developing strategy and assisting businesses, our members will likely be given key responsibility in most cities to develop the local plans, putting into action the tools provided in H.R. 2965 and other economic development legislation.

There are many issues to be addressed before a final legislative solution is achieved: Should the emphasis be on jobs in the area or employment for residents of the area? What areas should qualify and what boundaries if any, should be established for redevelopment areas or economic development districts? How do new incentives relate best to existing program strengths? Many other issues remain.

I would like to focus my remarks today on two major purposes:

First, I would like to address the single major present obstacle to job creation and economic development and how this and other legislative initiative can better address this need. This obstacle and this need are financing—debt financing to meet capital expansion and operating needs.

Second, I would like to address specific provisions of H.R. 2965 which can benefit most from my experience and that of the other economic development practitioners in APA. These include: planning in the action process; coordination for greater impact; essential direct financial intervention; reporting, evaluation and feedback; boundaries and benefits; and priorities to ailing urban economies.

In the area of economic development, legislation certainly must address comprehensive, long-term needs and the full range of economic development tools. But the legislative process is a continuing one and this provides the opportunity for legislation passed at any point to focus primarily on the major needs of the time. In two to three years, needs may change and thus new or updated legislation will be required.

There is an old saying that when you thoroughly understand the problem you are a long way toward the solution. As a consultant with a long experience in aiding communities in making economic policy and development decisions, I have had a tendency to agree. Once the decision makers have a thorough understanding of the alternatives and their respective implications, they are able to make intelligent decisions which achieve their constituents' objectives.

As a businessman, however, I have come in recent years to question the old "understand the problem" adage.

We in the public economic development field and the private real estate and business development field—they are really just two sides of the same coin—are clear on the problem but totally at a loss as to the solution.

The problem is money and the lack of same. Not equity, which in the past was thought to be the primary retardant to business development and job creation, but rather debt: "front end" debt capital for project and business start up; continuing debt capital for expansion; debt for physical facility and equipment and other "one-time expenditures;" and debt to supplement operating cash flow required to enter new markets, increase levels of production and weather periods of "soft" demand.

Growth in jobs is generated by new firms and old, large firms and small. With very few exceptions, all require debt capital to bring about job growth, and in fact often to sustain present employment levels—an equally important source of job support.

Quite frankly, in today's money market, it is virtually impossible to put money to work at a productive enough rate to generate adequate operating profits to handle the extremely high borrowing costs at the prime rate. And this is the rate given the most favored corporate borrowers, let alone the prime rate plus three or four points that the small and/or beginning business must pay—if financing can be obtained at all.

Many lenders are now almost totally out of the business and development financing market. Rather, they are taking a "wait-and-see" attitude on interest rates and are investing in money market funds or taking major equity positions in "inflation responsive" businesses.

The authors of H.R. 2965 should be commended for addressing the financing issue, both through continuing the ability of the Economic Development Administration (EDA) to make grants and by increasing the public-to-private loan ratio for small business investment companies.

But we would suggest that they consider supplementing this useful bill by adding provisions which place a much greater emphasis on increasing the availability and reducing the interest cost of debt capital for operations and capital expansion. That is where the depressed area economic development leverage of the early 1980's is greatest. Perhaps this will not be the case by the mid-1980's for which Congress is now legislating.

I believe this is true not only in the Nowak bill but in Kemp-Garcia, Heinz-Riegle and Rangel bills as well. The accelerated depreciation deduction and employment and other direct tax credits are important and they should be retained in the legislation. The grant capacity has been used effectively in many cities in the past and it should be retained. In all cases, individual assistance to a business or development should be supported with an overall economic strategy to insure that the greatest potential private leverage is achieved with the scarce public dollar.

That said, let's face it. Nobody can get a loan they can afford today. Not for physical facility expansion and not for continuing operations. Paying a twenty-five percent cost of operating capital, even assuming an inventory turnover four times annually—which is very high, a business desiring only a minimum fifteen percent return on sales must achieve an incremental operating profit at over twenty percent (before taxes) after cost of goods and labor and other direct expenses. This is virtually impossible in all but a few phenomenally successful industries. It is certainly not a reasonable expectation for new business or those operating with the typically higher operating costs of depressed areas. With profits retarded by interest costs, tax deductions are of relatively little value.

Since debt is the key retardant for all start up and expansion of business, and I would submit that our experience shows that this is particularly the case in depressed areas, we would recommend the legislative solutions bear more directly on the problem.

Tax deductions and credits are important and they should be focused to a major extent on lending institutions. Perhaps interest on secured capital improvement acquisition and development loans to business locating in depressed areas and/or employing income eligible employees for primary use in these designated areas, should be tax free to the lending institutions for five years.

Grant authority, whether centered in EDA or another agency, should be focused on filling the interest gap between what the individual business can afford, assuming an otherwise solid business operation, and what the market now demands. A substantial share of the grant funds would be used to set up an actuarially sound loan guarantee or insurance fund to aid sound business to expand in these "interest-troubled" times.

We do not suggest that targeting a major thrust of the legislation on borrowing availability and cost eliminates the need for continuing support for land acquisition and assemblage; training, retraining and transitional manpower support; and targeting market priorities and more rational labor management relationships. These are all important long-term objectives as are the general tax policies proposed in the legislation.

However, we are confident that today's critical variable is money availability and cost and we would propose that this be a major concern of the 97th Congress.

As examples, let us examine some recent experience we have had in several of our metropolitan markets.

In Louisville, the Station Park area had outlived its role as a mixed-use residential neighborhood. It was ripe for conversion to industrial use to accommodate industries presently located inside Station Park and other areas in the central city so that these industries would not have to relocate to other areas.

Our work showed that the market was strong and in fact letters of intent were obtained from enough tenants to make the first phase of development happen. A creative financing strategy was developed using Federal, state and local funding and the project was ready to move. And then the money market deteriorated and the project may well be "on hold" while the city reconsiders its ability to absorb the much larger than anticipated deficits caused by the escalated borrowing costs.

In Kansas City, a very exciting project aimed at enhancing the strong agricultural base of the area through the development of an "Agriplex"—including permanent sales, display, training, educational and museum facilities—has passed the preliminary market and feasibility test and is ready for development packaging. The project will likely be postponed until some way is found to reduce borrowing substantially below the presently available rates even for industrial revenue bond financing.

The situation is much the same for individual businesses attempting to expand to new locations and increase sales and employment levels in existing operations. The diversified manufacturing, wholesale and retail operation in which I have an interest has generated impressive sales growth in its ten-year history and had built up a large and rapidly increasing backlog of wholesale orders. With this success has come rapidly increasing demands for working capital. The combination of wholesale sales success and "sky-high" interest has caused total interest costs this year to be twice that budgeted forcing the deferral of employement expansion in the manufacturing sectors of the business. All of the retail, wholesale and manufacturing operations of the firm employ a high proportion of low-skilled workers with substantial opportunities for on-the-job training and advancement.

These are but a few of the economic development and job creation situations which have been held back by money market constraints. This money market constraint is not only making private market expansion almost impossible but is retarding the effective utilization of the Urban Development Action Grant program and other operative Federal initiatives. An effective Federal response is essential in this financing area.

Let me now turn to some comments specifically on H.R. 2965.

Planning in the Action Process.—I join with the Association in commending Representative Nowak in recognizing that the scarcity of Federal funding for urban development programs which we face today requires that all public funds, whether they be direct as capital grants or indirect as capital incentives, be applied to those business opportunities which will generate the most positive impact in jobs and other benefits.

This will only be the case if the governmental unit with most direct development influence evaluates its economic development options through a thorough planning process. Such a process requires local decisionmakers to adopt a set of priorities among the potential candidate businesses and other development opportunities each year.

This planning and priority setting is perhaps the most important step in the action process, and we support the bill for requiring an effective planning effort and also making an eligible activity for funding under the legislation.

Coordination for Greater Impact.—We commend Representative Nowak for requiring that the Secretary, as Federal lead, seek to coordinate this program effort with the activities of other Federal agencies. We would urge that this coordination, when combined with the local government coordination, which would be a vital part of the local planning requirements previously discussed, will do much to insure that the Federal government generates the maximum "return on its investment" through this legislation.

Essential Direct Financial Intervention.—This legislation is clearly grounded on local economic development experience rather than major corporate financial interests. This bill reflects the need for federal funds to aid localities in making public infrastructure and other investments required in many cases for private business to expand. Whether these funds are administered by EDA or another agency and whether they total $300,000,000 or a larger amount, the need for financial aid is essential in the start up stages in business, when tax credits are minimal at best. This comment relates to my earlier testimony.

Reporting, Evaluation, Feedback, Etc.—We are pleased that the legislation would require an immediate and continuing feedback to the Congress on its accomplishments. We wonder, however, if these dollars cannot better be spent by establishing, at the very beginning, an effective set of funding guidelines and letting the successful results speak for themselves in hearings such as those we are holding today.

Boundaries and Benefits.—This is certainly a difficult issue, the proper response to which turns largely on what we judge to be the primary objectives of the legislation. To the extent that providing jobs and "shoring up" the tax base of cities are the primary objectives, I would question the need for boundaries. Does it not make more sense to apply incentives to businesses which will best leverage public funds to create the desired economic benefits rather than designating specific geographic areas which in many cases will benefit some businesses at the expense of those in other areas of the same city?

Priority to Ailing Urban Economies.—We commend the emphasis of the legislation on those urban areas within our nation which, without such Federal assistance, are not succeeding in generating an adequate supply of jobs and other sustaining benefits for their residents. While boundaries within these areas seem to me to be an unnecessary retardant, setting priorities among urban areas is valid. The criteria set forth in this legislation represent a good beginning.

Let me end my testimony by saying that all the members of the American Planning Association join me in thanking the Chairman and the Subcommittee for focusing on urgent economic development needs. If we can provide any additional input to your legislation development process, we would be pleased to do so.

Mr. NOWAK. Thank you very much.

Once again we're called to the floor for a vote and I am wondering if all three could stay around for a few minutes until we come back—it will be within 10 minutes. Would that be all right? OK.

We stand in recess for 10 minutes.

[Recess.]

Mr. NOWAK. The subcommittee will come to order, and Mr. Centner has a couple questions he'd like to ask.

Mr. CENTNER. Thank you, Mr. Chairman.

From what I gathered in the testimony—and these other gentlemen might want to contribute to this—it strikes me that there may be a semantics problem.

Different people have been using the work tax incentives, I think, in slightly different ways. And I'm wondering, as you heard the testimony today and heard people talk about the fact that tax incentives may not be the real answer to spurring growth in small business among entrepreneurs, that their idea of a tax incentive is considerably different from what you're talking about as a tax incentive.

I wonder if you could explain that difference because I think it's important.

Mr. BUTLER. Yes; I think so. I don't think there's a basic disagreement between my view of the effect of tax incentives and many of the people who say they are very limited. I think most people when they talk in terms of tax incentives do mean tax incentives that are enjoyed by the business itself, depreciation allowances and other kinds of credits. I agree entirely that it's certainly small new businesses which can really enjoy these as well as the branches, small branches of existing businesses or larger businesses. In fact, the National Federation of Independent Business I know in several of their surveys asked new businesses to rank the impediments to their growth in the early days, and taxes are really way down the list because they don't pay them anyway. So what is the use having a credit.

But the distinction I drew and I emphasize it again, is that a tax incentive on the other hand that alters the climate from the investor's point of view is a rather different kind of thing. Because there you're talking about people who may be choosing between risking their money in a dismal business or putting it into a tax shelter of some kind. They may be on very high rates of tax and they're looking at a condominium as opposed to the small business. And altering that situation, giving them incentives or what I think of as rectifying the disincentives that now exist, I think is clearly a way of unleashing a great deal of capital available for small business development.

Mr. CENTNER. Based on that answer, Mr. Marriott has a small business participating debenture bill that includes—unlike the ones that are in so far this year—a 20-percent or $20,000 investment tax credit for the investor up front, or a 30-percent or $30,000 investment tax credit in the case of an investor who puts the money into a disadvantaged or minority business, and I think the three of you are probably relatively familiar with the fact that you get the same tax benefit you would with preferred stock on the outside or on the out years.

Mr. George was talking about interest rate subsidies. I am wondering if this kind of approach may not do exactly what you're talking about, without actually fooling with interest rates; and, of course, for a lot of conservatives fooling directly with interest rates is a capital sin—if you'll pardon the pun.

I wonder if Mr. Butler and Mr. George might address that.

Mr. BUTLER. I think that kind of mechanism fits in with what I have argued as being the most effective way of bringing new capital to bear on new businesses, because as you pointed out that provides a benefit for the investor primarily.

I think in my formal statement to the committee I mentioned that the British at long last were beginning to drift along similar lines in terms of trying to give a tax relief to somebody putting investment in small businesses in particular areas. And I think that is a result of improved analysis, if you like, of the nature of small business development and the precise impact of tax incentives on new business formations; that we must get away from the idea of trying to give relief to the business itself and much more to the person who is choosing between that business and an alternative.

Mr. GEORGE. I have not read the legislation. I would like to, and then get some comments to you. I think the structure of the investment is extremely important in that case. One of the things that entrepreneurs hate more than lack of financing is working their heads off and giving away part of the ownership. I think if we were able to structure this, as say convertible preferred stock, which could be purchased back at an agreed upon price by the entrepreneur at a later stage, the immediate tax writeoff, the credit as opposed to the deduction would in effect be effective interest.

Mr. **Butler**. Let me just explain that there is no equity involvement at all. It's totally a loan, and the benefit to the lender is that he gets a negotiated share of company profits for a given number of years, so that there's never any ownership involved. And we did it on purpose because of what you had said earlier about the fact that most small business owners—I think you were the one that said they were feisty individualists, and we realize that and obviously they didn't want to have somebody buying into the company.

Mr. **George**. Well, I think to the extent that it would not permanently erode the ownership it would be extremely useful as a source of what in effect would be debt capital—and I want to make that distinction again; the shortage is not equity capital. When we talk about attracting investors into small businesses if we're talking about attracting investors into equity positions in small businesses we're not dealing with the problem.

Mr. **Nowak**. The followup on that question, you know the way the interest rate has performed really is in many instances I guess deterring people from investing because of the return that you can receive—say on a money market certificate. This complicates this whole scenario a little further because really you're making a choice between a checking account that pays 17 or 18 percent and the investment that traditionally if it paid 20 percent, most people would be very happy with.

And that kind of competition—just reading the figures from last Friday—the money markets have gone to $151 billion. I don't know where $151 billion was prior to this but it must have been out there and not invested because those dollars all of a sudden showed up very fast—when that 17 or 18 percent was obtainable.

And, you know, your premise that people would invest and the entrepreneur would let him invest still doesn't come to grips with the competition from these so-called money market certificates. I wonder if you had any thoughts about how to get equity or debt capital, when you're competing with those types of rates.

Mr. **George**. I believe that the administration has failed in some ways to come to grips with this in their hopes that by cutting taxes, with most of that tax cut in dollar amounts being in the upper brackets, the firms benefiting from the cuts would flow those funds into capital-producing investment as opposed to money market funds.

You're taking the responsibility for an investment decision away from us. We're all busy with what we do and we don't have much time for financial planning, and if you're going to give us 17 or 18 percent without making a decision—which in effect that is—it's very hard to attract us into an equity position.

I think that's a broader question than the one we're talking about today. Is it logical for funds liberated through tax cuts to be invested in risk situations—and all capital-producing situations are risk by nature—when there are nonrisk, almost nondecision alternatives such as money markets around?

What we are doing, though, is saying even with the tax cut the income tax burden of many individuals is substantial, I'm not saying it's too high, but it's substantial and a target for reduction, and when we can reduce the tax implications of earning interest, and therefore increase the after-tax share of the interest paid, we can help by setting requirements as to the kind of investment, job-producing or small business expansion or whatever our objective might be. In some small way we are beginning to get at that problem.

Mr. **Nowak**. I am wondering, you know, if we don't look at that interest rate directly whether we're able to put together enough incentives to compete with that 17 or 18 or 20 percent—whatever it may be.

And you know, when you look at what's transpiring, really there is a tremendous shift of dollars flowing into the money markets from even the savings and loan, and, you know, we put two financial markets at odds with each other. Where the dollars used to flow for the home construction industry, which affects such a wide economic base out there, and that is slowed down, how do we still overcome that type of investment?

Mr. **George**. Well bills, such as the Marriott bill that in effect changed the relative interest or near-interest yield, regardless of what technique they might use, are the only tools that we now have available to do that, and I think it's essential that that be done, that the cost of capital to business be reduced if our objective is to have that business grow.

Mr. **Nowak**. Doctor, I wonder if you would comment on that. You know, from the point of view of changing investment decisions out there, suppose when we change the tax law someone sees that as an incentive but some other sector is finding the same so-called incentive acting as a disincentive to them—you know, the shifts of dollars. I guess the money market is a prime example of what's transpired here.

On the other hand, if we have tax exemptions won't that tend to keep up the basic prime over a long period of time, and aren't we really creating a secondary market, a secondary finance market in the whole real estate industry?

If you talk to real estate people who are out there in the field, you know they tell you that the only properties that are selling are those that are financed by the sellers themselves—and, at a discounted rate. So we're putting together the capital to sell a home, by a new mechanism that's never been used in this country.

And this is causing less activity in regard to mortgages and the distortion in financial markets. As a result, municipal bonds, the bond market, and all the bond market—something between 40 and 50 percent—have been reduced because of that interest rate.

We had talked in this subcommittee when we had interest rate hearings about the possibility of two tiering a rate, and taking the small business or equity investment that's made by an individual and perhaps putting that at 3 to 4 percentage points below what the so-called prime is flowing in at that time.

That, of course, is skewing the economy also, but we're skewing it, you know, in the traditional way to get more money out there for so-called productive purposes—for the small business community, homebuilding, and automobile sales. If we are going to move the tax law so that it raises that rate and skews it the other way—although many people object to the Fed putting in the two-tiered rate—I am just wondering if for balance and for the long term here in our so-called productive sectors we're not overlooking them and making it almost impossible for them to attract the kind of capital and credit that they need to sustain themselves by long term paying out the rate.

Dr. Butler.

Mr. BUTLER. Yes. I'm not quite sure exactly what you mean by putting the rate at certain percentage points below the prime rate, quite how one does that.

Mr. NOWAK. Well, if I may—you know, the simple concept of helping out the banks so they would be excluded from their reserve requirement or something—give the banks some internal incentive to loan the money out to the small business and homebuilders, and for so-called productive loans rather than pure consumer credit. Let that pure consumer credit stay up where it is and try to get more investment into this other area to offset, is what I am saying.

We can talk about the Federal deficit and all that, but during this time we're probably looking at 4 years minimum before this deficit comes down to where the interest rate will appreciably get lower.

Mr. BUTLER. I think the point you made right at the beginning about the severe problem one has in this particular period of high interest rates and the relative attractiveness of different capital markets is very important, and it's going to be extremely difficult to find mechanisms to offset that and to encourage redeployment of capital.

Hopefully, the administration is correct in feeling that these very high interest rates are going to have a short-term effect, and I think in the short term there is very little we can do to offset that accumulation within the money market funds, and to some extent in real estate.

In the long run—of course, as Keynes said, in the long run we're all dead—but in the long run I think we should still focus on the very basic underlying incentives that still exist, the disincentives to put money into more risk-orientated kinds of businesses. And hence I do feel that the reductions in personal tax rates to encourage savings, and so forth, are going to be more important in the long run.

As far as short-run considerations are concerned I think that there is another factor as well, that of course, there are opportunity costs and relative prices between putting savings into certain alternatives and that cost of capital, but there is also a cost and a price effect of looking at consumption as opposed to capital, and that alternative form of acquiring capital.

By that I mean, for example, if money is cheap a business can hire somebody to improve their facility, to make it more businesslike and so forth. If money is expensive, then perhaps an appropriate use of factors of production would be for the proprietor to do the work himself.

I just say that as a very crude example of the fact that the factors of production can be switched to some extent, and maybe we should be looking at that. And also ways of just bringing down the capital requirements for starting up businesses.

I think when we are looking at things like regulation, when we're looking at zoning, for example, at the city level—we find many buildings that are available at relatively low cost that are tied up because of the restrictions on the uses of such buildings. That is a way of bringing down the cost, the capital requirement in the sense of cash you need to start up businesses.

I think this is important in the long run, but in the short run these are possible ways of having a much more tangible effect, particularly in targeted areas—than maybe trying to manipulate the rate of interest. I just throw that out as a general point.

I am just skeptical, really, of our ability to overcome very powerful forces that exist when shifting around where money is concerned.

Mr. NOWAK. Yes, Leo.

Mr. FISHMAN. If I may make an observation, there is also a secondary effect to high interest rates. We always look at investment as balancing risk versus after-tax return. But in entrepreneurial activity very frequently the risk is not really assessed in its fullness. We find that the entrepreneur having assembled a pool of capital is willing to jump in, regardless of what the cost might be, and regardless at times of what the costs of debt might be. This may have a retarding effect on rational expansion decisions for small business.

Very often the cost of money is going to implant itself later on in the operating history, so maybe 2 to 5 years down the road you have a company that can no longer make debt service, and goes under. So I think that what we're confronting is not just an initial investment decision but also the health of a company once it starts up, and about 2 to 5 years down the road where the impact of the cost of money, as well as other costs, suddenly comes to bear on the situation.

Mr. NOWAK. If I may ask one more question, for you, Leo.

You had mentioned a subject that is near and dear to my heart and that was employee stockownership plants—trying to widen the ownership, whether it be businesses or stock. I am sure you are familiar with a fellow by the name of Louis Kelso, who for, I don't know, umpteen years I guess since I heard about it, is trying to push the concepts of these plans—broadly, narrowly and every direction you can. That concept, of course, has proven I think very effective in some small and in fact some very large corporations.

Some very large corporations in Rochester, I understand, are still without a tight organization as far as their labor force is concerned, but because they all participate in some type of bonus-sharing at the end of the year. That participation in the stockownership has seemed to make a big difference in small corporations that, perhaps, at one time were very unproductive, and all of a sudden the productivity problems just disappeared overnight when, you know, a percentage of the total profits were shared with employees.

I think it gives a different perception to people, too, who are out there working and makes them a totally different person, and makes them view the so-called enterprise system in a different light also.

I wonder if you had any other thoughts as far as how we could make this concept actually come into being in these enterprise zones—with the constraints that are out there now, to try to form an ESOP, or broaden employee ownership participation.

Mr. **Butler**. I think there are many mechanisms that are potentially of use in such areas, and I agree that this is an extremely important element, particularly when you're looking at highly depressed communities. We also find that not only when the employees themselves have a stake in the development of the business, but when the community as such has a stake, you find people prepared to start doing things that otherwise they feel no particular reason to do.

So I think the mechanism of ownership and the spread of ownership is going to be extremely important, particularly as we are trying to draw in existing community organizations.

To expand on that, as far as particular mechanisms that we might look at within our enterprise zone, I think these do hold out a possibility. I think forms of cooperative ownership may be an interesting mechanism to look at, too.

It's been suggested that an increase in the number of shareholders under subchapter S might be a possibility, too, to give some protection for shareholders within depressed areas, to reduce the risks for people with very limited capital available. Those kinds of things may be an effective way of doing it.

I know the community development corporations and similar groups based in the communities themselves are looking at the same kind of thing and getting a community ownership.

One of the things that the enterprise zone, of course, is trying to do is to create a climate where precisely such innovative ways of doing business, of working with other businesses, stand a better chance of being successful. And I would hesitate, myself, to second-guess exactly what the ideal form of spread ownership should be in any particular area. I think we should keep that fairly flexible, but really examine ways of encouraging that form of ownership.

As I said, I think it's particularly applicable to the conditions in depressed neighborhoods.

Mr. **Nowak**. Thank you. Mr. Roemer.

Mr. **Roemer**. Thank you, Mr. Chairman.

I have a question of each of you; it's the same question, and I'll begin left to right if we could.

A quick observation about interest rates before we begin. I believe it was Mr. George who suggested that we might want to subsidize the lending rate as the most direct way to help. A lot of things affect interest rates. One thing is competition within the capital markets.

For example, just coming back from the vote I saw a sign on the Employees' Credit Union down by the subway—you might have seen it, Henry—that said, "Money market funds sold here."

That kind of competition the deregulation has caused, it just so happened to coincide with other economic forces that have caused these rates to go sky high, but my question is: What two or three changes would you make in the enterprise zone concept to make it work better—what specifically—what two or three things, and some of you have suggested a number of things. But if you could limit it to two or three most closely held ideas to make this idea work better, what would you suggest?

And then give us one word at the end of that, as to whether or not if the changes were made in your direction will the enterprise zone prove to be beneficial to economic development in this country?

Mr. FISHMAN. Obviously a most difficult question.

I think there has to be a direct capital injection in order for the zone concept to work in multiple locations. I think that perhaps the way it proceeds now would be sufficient in a number of places, because other forces, State, local, or private, would come forward. But in other areas where the problem is as evident as anywhere else, I see no substitute for some direct form of intervention, whether it is Federal funding of an institution, a development institution within the zone itself, or direct capital injection.

I think that a number of techniques and mechanisms that might be suitable are already provided for in legislation.

Mr. ROEMER. Anything else, Mr. Fishman?

Mr. FISHMAN. I have explained already that I think I have some doubts about the effects of certain provisions that are already in the bill, and I think I would not have anything to say if I were to assume that those factors are going to be positive, if those provisions are going to have the intended effect. I think if that happens, fine.

I would only mention the fact that training—employment training is one of the most difficult undertakings there is, and Government units and private industry have been involved in training efforts for years. In distressed areas and in working with CETA eligible applicants I do not think at the moment there is a technique that can train people suitably and acceptably on a wide basis that would be sufficient to bring this about. How that technique can be developed, is again beyond me.

Mr. ROEMER. So capital assistance and a training program designed to actually train people you think would be two critical requirements to make the EZ concept work?

Mr. FISHMAN. Yes. I know I'm being repetitious in talking about training, but I would think that there are massive time dislocations where you train people today for yesterday's needs. And the only way I think that can be overcome is by a joint effort between your educational system and your private employer. And that has to be a joint effort and fully supported here.

Mr. ROEMER. Thank you.

Mr. Butler, you do the same—and we are under some time restraints. I don't want to shut you off, but——

Mr. BUTLER. I would say that if there were one legislative change that I think should be concentrated on, that would be bringing down the tax liability for people who are choosing to invest in these areas. I think that's a central thing we can do at the Federal level.

I think second, though, in looking at designating zones, that there should be a great deal of pressure, if you like, on cities to look at ways of unlocking activity within certain areas so that land and buildings become more available, and that the time constraints, particularly the time restrictions on licensing and other types of formalities to create businesses should be drastically reduced.

And third, I think that cities should be encouraged to look at what is going on in these areas in terms of some of the small elements of strengths that are there. I mean particularly community based organizations, and to use those as a means of growing and affecting the social situation and linking them with the development process.

So, really there is only one legislative thing I would suggest; but in terms of picking areas I think those other two elements at the local level are extremely important.

Mr. **Roemer**. Thank you.

Mr. George.

Mr. **George**. Let me be brief. I think first of all it's essential that the objectives of the legislation be crystal clear. I would submit there should be jobs and tax ratables, but whatever they are to be, they should be crystal clear. They shouldn't be complicated or multiple.

Second of all, it seems to me that it's essential to be also crystal clear who is managing this program from the Federal Government standpoint. And we've got several agencies in all of these bills, and that's just what I was talking about before.

Mr. **Roemer**. The management concept being important.

Mr. **George**. It be crystal clear, that it be in the legislation and not in terms of the Secretary will coordinate with the other secretaries. I mean, who's on the line? Who comes before this committee and you say well, how come it hasn't worked? I think that's essential.

Third, I think it is very important from a leverage standpoint in order to get the maximum leverage out of your dollars, regardless of what those objectives must be, that those dollars be applied to the debt financing issue. I know that's difficult, but that's where the leverage is, and we're all talking about cutting back the funds and getting the greatest leverage. That's where the leverage is. Ask the man on the street or the guy in the corporate board room, and that's what he'll say.

Thank you.

Mr. **Roemer**. Thank you, Mr. Chairman.

Mr. **Nowak**. Well, let me just conclude. I had other questions, and Doctor, for one, I understand you are very familiar with the English zone that has been established, and I wondered if you could provide the subcommittee with the exact type of incentives that they are operating with and also what your opinion is as to their success and how we could improve upon it.

I don't expect you to answer that at this point in time, but we'll keep the record open so we can have that experience, and your critique of that experience as we go along with this proposal.

Mr. **Butler**. I have a paper which I could make available which summarizes that.

Mr. **Nowak**. Fine. We would appreciate that.

And just let me thank each of you for your patience.

We have run a little longer than anticipated. But I think it's a subject that has never really been discussed very broadly. You know, everybody gets a piece of this thing, and it's all over in the Ways and Means and HUD, and you know, the Education and Labor Committee, and they look at their own area and walk away from the other problems that are existing out there that could be affected.

So we hope that we can draw some of it together and talk in terms of what narrowing we could do as far as input into both the Congress and the administration as they struggle with the questions of reductions.

I firmly believe that many of the dollars in other agencies—EDA and others—have been thrown out there for really different purposes, conflicting purposes, and if we ever could get to the manager you're talking about, to pull all of that together and bring to bear these incentives into workable and simple methodology for actually implementing them we'd be able to do much more with much less dollars that are out there.

I just want to put in the record that Herb Liebenson of the National Small Business Association had to leave because of the hearing length, but we are going to insert his prepared statement in the record.

[Mr. Liebenson's prepared statement with attachments follow:]

PREPARED STATEMENT OF HERBERT LIEBENSON, NATIONAL SMALL BUSINESS ASSOCIATION, ON BEHALF OF SMALL BUSINESS LEGISLATIVE COUNCIL

Mr. Chairman, we appreciate your invitation to present our views on the potential small business contributions to jobs creation and urban revitalization.

I am Herbert Liebenson, President of the National Small Business Association and Executive Director of the Small Business Legislative Council.

The National Small Business Association (NSB) was organized in 1937 and now has approximately 50,000 members nationwide in all lines of industry.

In 1977, NSB organized the Small Business Legislative Council (SBLC) as a coalition of national trade associations with primarily small business membership. The SBLC has over 70 member organizations representing about 4 million small businesses.

For the past half dozen years our associations have given extensive attention to the question of how public policy could take best advantage of the job creating capabilities of the country's 15 million small enterprises.

THE PROBLEMS

Unemployment and urban decline have been two of the most serious and persistent problems facing this nation.

At the beginning of this month, stark figures from the U.S. Department of Labor showed unemployment rates at the following levels for various categories of workers:

- For all workers: 7.2 percent
- For black workers: a record 15 percent
- For minority teenagers: an all time high rate of 45.7 percent
- For black teenagers: 50.7 percent. 1/

1/ "The Employment Situation; August 1981," U.S. Department of Labor Release USDL 81-438, September 4, 1981. Also, see: "Black Teen-Age Joblessness Bring Rise in U.S. Rate," by Seth S. King, New York Times September 5,1981; "Black Jobless Rate Hits Record 15%; Price Rise Moderate," by John M. Berry, Washington Post September 5, 1981, page A-1.

As to urban policy, some researchers have concluded that despite several high visibility construction projects, such as the Inner Harbor in Baltimore, Queen Village in Philadelphia, and Adams-Morgan in Washington, the over-all trend is continued decline for most older U.S. cities. [2]

This study spans the years 1960 to 1970. It is based upon an "urban conditions index" for 60 of the nation's largest cities derived from factors such as the average age of their dwelling units, population gain or loss, and concentration of poverty. The conclusion was that rich cities are getting richer and poor cities are getting poorer.

The interrelations between urban decline, poverty and joblessness are many and varied, as indicated by the testimony before this Subcommittee of Mayor James Griffith of Buffalo, a city whose unemployment rate is more than 12 percent.

IMPACT OF 1981 TAX LEGISLATION ON JOBS

This year's tax bill favors investment in heavy industry, a sector of the economy that generates few jobs. A survey by the House Small Business Committee some years ago established that the largest 1,000 U.S. corporations have been accounting for less than 5 percent of the net new private jobs.

The Administration's projection is that its complete program -- composed of tax reductions, domestic budget cuts, increased defense spending, monetary restraint and regulatory reform -- would increase employment by 7.5 million by 1984, but this would reduce the unemployment rate by less than one percentage point, from 7.3 percent to 6.4 percent.

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[2] "Study Says Old Cities Continuing to Decline," Washington Evening Star, September 7, 1980, page H-1.

PUBLISHED STATISTICS UNDERSTATE THE PROBLEM

We believe that official unemployment statistics substantially understate the magnitude of the nation's employment problems in at least three ways:

- ° First, there are people who are so discouraged they have quit looking for work. The Labor Department estimates that there may be more than one million people in this category.
- ° Second, when self-employed persons become jobless they are not eligible for unemployment benefits, and therefore leave no tracks in the system. The rise in bankruptcies to a record rate of 4,000 per month suggests that unemployment is becoming a greater factor in the economy 3/; and
- ° Third, unemployment benefits will soon be exhausted for many workers, intensifying economic distress.

Accordingly, our associations are gravely concerned over urban unemployment and believe corrective action is urgent.

JOB GENERATING POTENTIAL OF SMALL FIRMS

Our position for the past half dozen years has been that small business should be the employer of first resort, with an incentive provided by a general jobs creation tax credit.

We believe there is wide agreement among those who have studied this field that small enterprises are in a unique position to help in the solution of these problems by providing new jobs throughout the economy, including urban areas.

The Small Business Administration estimated that small businesses account for 55 percent of existing private sector employment, 59 percent if farming is included.

Professor David Birch of MIT found that 52 percent of all new jobs between 1967 and 1976 were created by independent enterprises with fewer than 20 employees.

3/ Report on Bankruptcies, National Small Business Association, Sept. 21, 1981

The National Alliance for Business also testified to the Senate Small Business Committee in 1978 that about three-quarters of the new jobs were generated by independent enterprises with fewer than 100 employees.

The dynamic qualities of small firms that engender competition, new opportunities, new industries and economic growth are becoming increasingly recognized.

Small firms which have survived in the urban environment must know their territory and the communities they are dealing with. Beyond this they are associated with the families and individuals of their neighborhoods. They are unusually well-qualified to make judgments on which persons would have good work habits and which can be trained and educated and increase their value as employees.

This capability is ready, willing and eager to be brought into the service of the nation.

Evidence of this is a 45-state survey of small business taken in 1974-75 following NSB's proposal for a jobs tax credit of half of the first year's wages for two workers per firm.

The results of that survey were that small firms would be willing to hire an additional 1 1/4 million workers if such a credit were enacted. 4/

Credibility is given to this figure by the actual results of enacting the general jobs tax credit in 1977. Under this program claims were made for a total of over 2 million new jobs in 1977-79, as illustrated in the following table:

UTILIZATION OF THE GENERAL JOBS CREDIT

	1977	1978	1979
Tax Returns Claiming Credit	614,000	1,142,000	300,000
Credits Claimed in $ Billion	$2.359	$4.513	$1.600
Approximate Number of Jobs	1,122,857	2,149,047	687,096

4/ NSB Press Release, September 24, 1975.

The credit had a built-in ceiling of $100,000 or 47 workers per firm. The number of firms involved indicates that the average is just about 2 workers per firm. So, it is probable that the great majority of these two million jobs were generated in small businesses.

In our testimony earlier this year to the House Small Business and Labor Committees on this issue, we pointed out that the general jobs credit is very cost-effective.

The price of unemployment to the U.S. Treasury is about $25,000 per person per year and the net cost of a jobs credit of $2,100 is $630 (for an employer in the 14 percent bracket) to $1,806 (for an employer in the 70 percent bracket). Thus, the Treasury and the nation would be getting an advantage if even one of every 10 new jobs were attributable to such a credit and nothing else.

In our opinion, these factors made the general jobs credit a tremendous success.

Our associations would like to see the general credit restored at a higher level to compensate for inflation since 1977.

ADVANTAGES OF A JOBS TAX CREDIT

The general jobs credit enjoys many advantages over other governmental jobs policies.

First, many past government job training programs have been complex and cumbersome -- requiring periodic certification of employee status. We have heard that it requires almost a full-time compliance officer to administer some of these programs.

Second, there has always been a gap in governmental efforts in the area of apprenticeship programs.

The federal government does not have such programs. Private employers who have gone to the time and expense of operating apprenticeship programs have often seen their best journeymen hired away by federal agencies at higher salary levels. In fairness, the federal government should have its own apprenticeship programs.

Third, there has been little attention paid to the problem of upgrading for higher-skilled jobs.

The National Tooling and Machining Association, one of our SBLC member associations, has pointed out that to keep pace with the normal requirements of the economy -- to say nothing of accommodating a rapid defense build-up -- the U.S. would need to train 9,000 tool and die makers and 23,000 machinists every year for the next decade.

According to the Wall Street Journal, apprenticeship programs graduated only 2,311 tool makers and 2,859 machinists in 1978 (February 5, 1980, page 1: col. 5).

NOWAK BILL GOOD IN CONCEPT

For these reasons, our associations are supporting the two-tier jobs credit bill (S. 3726) introduced by the Subcommittee Chairman [Rep. Nowak].

We believe the concept of extra incentives for skills training and for hiring the difficult to employ provide a reasonable structure that can be understood and applied by the nation's small business community to create jobs.

URBAN REVITALIZATION AND ENTERPRISE ZONES

There has been much discussion of the idea of an Urban Free Enterprise Zone where most taxes are reduced as additional incentives for business activity.

We have several questions about such a proposal:

°Where would smaller firms get the capital to acquire new facilities and equipment to take advantage of such a program?

°Would the reduced levels of taxation be adequate to provide necessary services in an urban environment, especially at a time when cities are being squeezed by lower revenues resulting from the 1981 tax legislation and having difficulty selling development bonds because of the high interest rates.

°Would such a program deal with the factors that led to the decay of these areas in the first place?

We hope this novel concept will receive more discussion and thought to the end that it becomes serviceable to the nation's small businesses.

SUMMARY

Four years ago, in support of the original jobs creation program, NSB told the Congress:

> We believe (there are millions of) small firm(s) which can take on an individual on a man-to-man basis...will give the trainee better supervision than a formalized training program. 5/

The extension of the targeted jobs credit was a step in the right direction, but it did not go far enough. We believe the general small business avenue to jobs generation offers great promise and it should be adopted as a substantial practical and immediate part of the solution to the nation's serious unemployment difficulties.

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5/ Letter in support of the Jobs Creation Tax Credit, H.R. 2691, February 14, 1977.

Policy Positions
# of the
SMALL BUSINESS LEGISLATIVE COUNCIL
1981

JOB CREATION TAX CREDITS

The 95th Congress refused to extend or expand a job creation tax credit which allowed a business to take a tax credit of 50 percent of the cost of hiring up to two new employees with a maximum credit of $20,000. Instead, Congress created a new targeted jobs credit and extended and expanded the Work Incentive (WIN) program.

Under the new targeted credit, a tax credit of 50 percent of the first $6,000 of wages per employee in a trade or business for the first year of employment, and 25 percent of such wages for the second year of employment, would be provided for hiring members of seven specific groups that have unemployment rates above the national average. The ordinary tax deduction for wages would be reduced by the amount of the credit. Wages eligible for the credit would be limited to 30 percent of the total FUTA wages paid by an employer.

The current WIN tax credit for hiring welfare recipients would be increased so that rates for hiring a business employee are the same as for the targeted jobs credit. The rate for hiring a non-business employee would be 35 percent of the first $6,000 of wages for the first year of employment.

As signed, the Humphrey-Hawkins bill was a far cry from the massive federal jobs and economic planning bill introduced by the late Senator Humphrey and Rep. Hawkins during the mid-1970s recession. But it retained the central goal of reductions of the unemployment rate to 4 percent by 1983. In addition, the final version tied a new national goal, a reduction of the inflation rate to 3 percent by 1983 and zero percent by 1988, to its unemployment goal.

RESOLVED
In the elimination of current high unemployment, the small business sector should be the employer of the first resort, with the incentive being provided by a job creation tax credit *without regard to the status of the individual.*

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Small
Business
Legislative
Council*

September 22, 1981

The position paper -- Job Creation -- is supported by the following members of the Small Business Legislative Council and other associations.

American Assn. of MESBICs
Washington, DC

American Assn. of Nurserymen
Washington, DC

American Metal Stamping Assn.
Richmond Heights, OH

American Pulpwood Assn.
Washington, DC

American Textile Machinery Assn.
Washington, DC

Assn. of Diesel Specialists
Kansas City, MO

Assn. of Indep. Corrugated Converters
Washington, DC

Assn. of Physical Fitness Centers
Bethesda, MD

Automotive Engine Rebuilders Assn.
Glenview, IL

Automotive Warehouse Distribs. Assn.
Kansas City, MO

Bldg. Service Contractors Assn. Intl.
Vienna, VA

Christian Booksellers Association
Colorado Springs, CO

Direct Selling Association
Washington, DC

Furniture Rental Assn. of America
Washington, DC

Independent Bakers Assn.
Washington, DC

Indep. Business Assn. of Michigan
Kalamazoo, MI

Indep. Business Assn. of Washington
Bellevue, WA

Indep. Sewing Machine Dealers of America
Hilliard, OH

International Franchise Association
Washington, DC

Inst. of Certified Business Counselors
Lafayette, CA

Local and Short Haul Carriers Natl. Conf.
Washington, DC

Manufacturers Agents Natl. Assn.
Irvine, CA

Marking Device Association
Evanston, IL

Menswear Retailers of America
Washington, DC

*Of the National Small Business Association

MN Assn. of Commerce & Industry Small
Business Council, St. Paul, MN

Natl. Appliance Service Assn.
Kansas City, MO

Natl. Assn. for Child Devel. & Educ.
Washington, DC

Natl. Assn. of Brick Distributors
McLean, VA

Natl. Assn. of Plastics Distribs.
Jaffrey, NH

Natl. Assn. of Retail Druggists
Washington, DC

Natl. Burglar & Fire Alarm Assn.
Washington, DC

Natl. Candy Wholesalers Assn.
Washington, D.C.

Natl. Campground Owners Assn.
Wheaton, MD

Natl. Coffee Service Assn.
Chicago, IL

Natl. Concrete Masonry Assn.
Herndon, VA

Natl. Electrical Contractors Assn.
Bethesda, MD

Natl. Family Business Council
West Bloomfield, MI

Natl. Glass Dealers Assn.
Washington, DC

Natl. Home Improvement Council
New York, NY

Natl. Indep. Dairies Assn.
Washington, DC

Natl. Insulation Contractors Assn.
Washington, DC

Natl. Office Machine Dealers Assn.
Des Plaines, IL

Natl. Office Products Assn.
Alexandria, VA

Natl. Paper Box Association
Haddonfield, NJ

Natl. Paper Trade Association
New York, NY

Natl. Parking Association
Washington, DC

Natl. Patent Council
Arlington, VA

National Peach Council
Martinsburg, WV

Natl. Pest Control Association
Vienna, VA

Natl. Precast Concrete Association
Indianapolis, IN

Natl. Small Business Association
Washington, DC

Natl. Society of Public Accountants
Washington, DC

Natl. Tire Dealers & Retreaders Assn.
Washington, DC

Natl. Tooling & Machining Assn.
Washington, DC

Natl. Truck Equipment Association
Oak Park, MI

Natl. Utility Contractors Assn.
Washington, DC

Natl. Woodwork Manufacturers Assn.
Chicago, IL

Oregon Feed, Seed and Suppliers Assn.
Portland, OR

Printing Industries of America
Arlington, VA

Retail Bakers of America
Washington, D.C.

Sheet Metal & Air Cond. Contrs. Natl.
Assn., Vienna, VA

Mr. **Nowak**. Again, let me thank you for your patience, and if we do have further questions as we go on to bring all this together, we certainly will be in touch with you.

Thank you again for appearing here. The hearing stands adjourned.

[Whereupon, at 3:47 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

[Material submitted for insertion in the hearing record follows:]

REMARKS BY JOHN HALL, FOR MARK BATTLE ASSOCIATES, INC.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

MY NAME IS JOHN HALL. I AM PRESIDENT OF MARK BATTLE ASSOCIATES, INC., AND I AM A MEMBER OF PROGRESS, INC., AND THE BLACK PRESIDENTS' ROUNDTABLE ASSOCIATION--TWO MINORITY BUSINESS TRADE ASSOCIATIONS. MY BACKGROUND INCLUDES MORE THAN TEN YEARS OF CONSULTING IN URBAN ECONOMIC DEVELOPMENT, WITH PARTICULAR EMPHASIS ON SMALL BUSINESS DEVELOPMENT. I HAVE RECENTLY CONDUCTED SPECIFIC RESEARCH ON URBAN ENTERPRISE ZONES AND ON THE ROLE OF MINORITY ENTERPRISES IN URBAN REVITALIZATION EFFORTS.

IT IS A PLEASURE TO HAVE THIS OPPORTUNITY TO MAKE THIS PRESENTATION ON THE CRITICAL PROBLEMS OF JOB CREATION AND REVITALIZATION OF SMALL BUSINESS. I WISH TO FOCUS THIS DISCUSSION ON THE MOST SEVERELY ECONOMICALLY DEPRESSED COMMUNITIES IN THE CENTRAL CITIES OF THE UNITED STATES, WHERE UNEMPLOYMENT RATES TEND TO BE HIGHEST, AND THE NEED FOR JOB CREATION TENDS TO BE GREATEST.

AT THE MOST BASIC LEVEL OF ANALYSIS, IT IS QUITE CLEAR THAT A HIGH RATE OF JOBLESSNESS IN A GIVEN COMMUNITY IS SOON FOLLOWED BY DETERIORATION OF THE AREA'S ECONOMIC VITALITY. I DO NOT WISH TO SPEAK TO THE MANY CAUSES FOR THESE "POCKETS OF POVERTY," BUT I WOULD LIKE TO SPEAK BRIEFLY TO THEIR EFFECTS, WHICH TEND TO BE REMARKABLY SIMILAR IN CITY AFTER CITY. ONCE THE UNEMPLOYMENT LEVEL GOES UP, HOUSEHOLD INCOMES, OF COURSE, COME DOWN AND THE UNENDING SPIRAL BEGINS.

- HOUSING UPKEEP SUFFERS, RENTS AND MORTGAGES GO UNPAID AND VACANT HOUSING APPEARS.
- AS FAMILY INCOMES ARE DIMINISHED, THE ABILITY TO SUPPORT AREA RETAIL SERVICES ALSO CONTRACTS, WHICH CAUSES RETAIL MERCHANTS TO RELOCATE TO MORE PROFITABLE AREAS.
- STABLE JOBS AND EMPLOYERS EVENTUALLY LEAVE THE AREA FOR A "BETTER BUSINESS CLIMATE" ALSO CAUSING MANY SKILLED WORKERS WHO MAY LIVE IN THE AREA TO LEAVE, FOLLOWING THEIR JOBS.
- THE TAX BASE TO FINANCE CITY SERVICES ERODES AND THE INFRASTRUCTURE OF THE AREA TENDS TO SUFFER.

WITH REGARD TO HUMAN RESOURCE DEVELOPMENT EFFECTS, ONLY TWO OF MANY FACTORS ARE MENTIONED HERE; BOTH ARE DIRECTLY RELATED TO THE ABILITY OF THE COMMUNITY TO PARTICIPATE IN ITS OWN REVITALIZATION AND JOB RE-CREATION.

- ONCE UNEMPLOYMENT BECOMES STRUCTURAL AS OPPOSED TO CYCLICAL, FAMILY AND COMMUNITY PRIDE AND ROLE MODELS DISAPPEAR, ONLY TO BE REPLACED BY THE "DISCOURAGED JOB-SEEKER."
- AS FAMILY INCOME DIMINISHES, THE SOURCES OF UPWARD MOBILITY BEGIN TO DISSIPATE AND THE FUTURE JOB PROSPECTS FOR AREA YOUTHS ARE JEOPARDIZED.

THE NET EFFECT OF THESE FACTORS IS THAT CONCENTRATIONS OF VERY HIGH UNEMPLOYMENT ARE MUCH MORE DEVASTATING TO A SINGLE COMMUNITY THAN HIGH UNEMPLOYMENT RATES EVENLY SPREAD OVER THE ENTIRE COUNTRY OR EVEN AN ENTIRE CITY. UNFORTUNATELY, IT IS TYPICALLY MINORITY NEIGHBORHOODS THAT EXPERIENCE THE DRAMATICALLY

HIGH CONCENTRATIONS OF UNEMPLOYMENT IN CITY AFTER CITY. IN AUGUST 1981, THE BLACK UNEMPLOYMENT RATE WAS 16.2 PERCENT, WHILE THE OVERALL UNEMPLOYMENT RATE WAS 7.2 PERCENT.[1] IN MANY COMMUNITIES THE BLACK UNEMPLOYMENT RATE REPORTEDLY EXCEEDS 40 PERCENT.[2] AN UNFORTUNATE REALITY IS THAT THE CONTINUING TRENDS IN THE LOCATION DECISIONS OF MAJOR MANUFACTURERS AS WELL AS NEW TRENDS IN THE LOCATION OF NEW SMALL BUSINESSES INDICATE THAT MINORITIES ARE MOVING IN ONE DIRECTION WHILE THE JOBS ARE INCREASINGLY MOVING IN ANOTHER.

- LARGE U.S. MANUFACTURERS WHICH USED TO LOCATE PRIMARILY IN MAJOR METROPOLITAN AREAS ARE INCREASINGLY RELOCATING IN REMOTE AREAS[3] (MORE THAN 200 MILES AWAY FROM MAJOR METROPOLITAN AREAS). SMALL BUSINESSES ARE THE PRIMARY SOURCE OF JOBS FOR MINORITIES[4] AND ARE THE DOMINANT CREATOR OF JOBS IN CENTRAL CITIES. HOWEVER, MOST SMALL BUSINESS START-UPS, WHICH HAVE BEEN THE SOURCE OF A HIGH PERCENTAGE OF NEW JOBS, ARE NOW IN THE SUBURBS RATHER THAN THE CENTRAL CITIES.[5]
- YET PRELIMINARY 1980 CENSUS DATA INDICATE THAT BLACK AMERICANS ARE CONTINUING TO CONCENTRATE IN THE CENTRAL CITIES OF METROPOLITAN AREAS.[6] MORE THAN 14 MILLION BLACKS OUT OF A TOTAL OF 26.5 MILLION NOW LIVE IN THE CENTRAL CITIES OF MAJOR METROPOLITAN AREAS, WHILE SIX MILLION OTHERS LIVE IN THE SUBURBS AND RURAL FRINGES OF THOSE AREAS.[7]

THERE ARE SEVERAL ADDITIONAL REASONS FOR THE UNEVEN DISTRIBUTION OF JOBS AND MINORITIES.

1. THE SKILL LEVELS OF UNEMPLOYED MINORITIES ARE NOT EVENLY MATCHED WITH THE SKILL REQUIREMENTS FOR MANY OF THE NEW JOBS.

2. THE MARKETS WHICH ARE SERVED BY MANY EMPLOYERS ARE NOT LOCATED IN CLOSE PROXIMITY TO THE HOMES OF UNEMPLOYED MINORITIES.
3. ECONOMICALLY DEPRESSED AREAS TEND TO BE AVOIDED BY TRADITIONAL SOURCES OF THE CAPITAL WHICH IS ESSENTIAL TO THE JOB CREATION PROCESS.
4. ALTHOUGH SMALL BUSINESSES PROVIDE MOST OF THE JOBS IN OUR ECONOMY, JOBS ARE NOT EVENLY PROVIDED BY SMALL MINORITY EMPLOYERS COMPARED TO SMALL NONMINORITY EMPLOYERS.

A MAJOR PROBLEM WHICH EXACERBATES THIS MALDISTRIBUTION OF JOBS, PEOPLE AND SKILLS IS THE DISPROPORTIONATE DEPENDENCE OF THE U.S. MINORITY POPULATION ON THE REST OF THE ECONOMY FOR ITS JOBS AND INCOME SUPPORTS. MINORITIES REPRESENT MORE THAN 20 PERCENT OF THE U.S. POPULATION,[8] OR MORE THAN 46 MILLION PEOPLE, YET MINORITY BUSINESSES IN 1977 EMPLOYED LESS THAN ONE MILLION INDIVIDUALS.[9] THIS LEAVES ALL THE REMAINING JOBS HELD BY MINORITIES TO BE PROVIDED BY THE PUBLIC SECTOR AND NONMINORITY PRIVATE FIRMS. SMALL BUSINESSES THROUGHOUT THE U.S. GENERATED MORE THAN TWO MILLION JOBS PER YEAR THROUGHOUT THE EARLY 1970S.[10] HOWEVER, FROM 1972 TO 1977 MINORITY BUSINESSES GENERATED AN AVERAGE OF LESS THAN 35,000 NEW JOBS PER YEAR.[11]

BECAUSE MINORITIES ARE DISPROPORTIONATELY UNEMPLOYED, THEY NATURALLY ALSO ARE DISPROPORTIONATELY DEPENDENT ON GOVERNMENT SOCIAL WELFARE EXPENDITURES. THESE GOVERNMENT SUBSIDIES HAVE INCREASED FROM $23 BILLION IN 1950 TO $394 BILLION IN 1978, OF WHICH $63 BILLION WAS THE FEDERAL PORTION OF THE MAJOR NEED-TESTED BENEFIT PROGRAMS TARGETED EXCLUSIVELY TO THE POOR.[12]

THIS STATUS OF DEPENDENCE IS EXTREMELY EXPENSIVE TO THE U.S. TAXPAYER. CONSEQUENTLY, EFFECTIVE DEVELOPMENT PROGRAMS DESIGNED TO REDUCE THE LONG-TERM DISPROPORTIONATE DEPENDENCE OF MINORITIES SHOULD ACCOMPANY ANY MAJOR JOB CREATION EFFORT AIMED AT DEPRESSED ECONOMIC AREAS.

PENDING JOB CREATION LEGISLATION SHOULD PROVIDE SPECIFIC INCENTIVES FOR RETAINING INDIGENOUS MINORITY BUSINESSES IN THE AREAS TARGETED FOR ECONOMIC STIMULATION. ALTHOUGH MOST MINORITY-OWNED FIRMS HAVE NO PAID EMPLOYEES,[13] NEARLY 3,500 MINORITY BUSINESSES EMPLOYED 50 OR MORE PERSONS IN 1977.[14] THIS GROUP OF SMALL FIRMS CAN REPRESENT THE INITIAL SEEDS OF A VITAL MINORITY BUSINESS COMMUNITY AND SHOULD BE PROVIDED WITH SPECIAL INCENTIVES FOR GROWTH. IF BETTER FINANCED NONMINORITY FIRMS ARE THE ONLY ONES TO CAPITALIZE ON THE TAX AND OTHER INCENTIVES, THE SHORT-TERM PROBLEM OF JOB CREATION MAY HAVE BEEN ADDRESSED, BUT THE LONG-TERM PROBLEM OF THE ECONOMIC DEPENDENCE OF 46 MILLION AMERICANS WILL NOT AND THE DISPROPORTIONATE DEMAND FOR GOVERNMENT SOCIAL SUBSIDIES WILL PERSIST.

SPECIFICALLY, WITH RESPECT TO URBAN ENTERPRISE ZONE LEGISLATION, THE FOLLOWING CONSIDERATIONS ARE RECOMMENDED:

- NEIGHBORHOOD ORGANIZATIONS AND AREA RESIDENTS SHOULD BE CONSTRUCTIVELY INVOLVED IN ZONE PLANNING AND MONITORING.

IT SHOULD BE THE RESPONSIBILITY OF EACH ZONE TO MAKE A PROPOSAL TO THE FEDERAL GOVERNMENT FOR APPROVAL OF A DESIGNATED AREA AS AN ENTERPRISE ZONE. PART OF THAT APPROVAL PROCESS SHOULD INCLUDE SOME APPROACH FOR CONSTRUCTIVELY INVOLVING THE COMMUNITY RESIDENTS AND ORGANIZATIONS IN THE ZONE DEVELOPMENT PROCESS. MINORITY BUSINESS TRADE ASSOCIATIONS ARE PARTICULARLY IMPORTANT. REPRESENTATIVES OF THE RESIDENTS SHOULD BE ACTIVE PARTICIPANTS IN ALL ZONE PLANNING ACTIVITIES; INVOLVEMENT IN THE FOLLOWING ACTIVITIES IS PARTICULARLY ENCOURAGED:

--DESIGNATION OF THE ZONE BOUNDARIES

--SELECTION OF THE ZONE MANAGER

--PREPARATION OF THE APPLICATION FOR ZONE DESIGNATION

--MONITORING THE PROGRESS OF THE ZONE BUSINESSES IN THE EMPLOYMENT OF TARGETED JOB RECIPIENTS

- FEDERAL TAX INCENTIVES SHOULD BE ATTRACTIVE TO A VARIETY OF TYPES AND SIZES OF BUSINESSES.

THE APPROPRIATE BUSINESS CLIMATE FOR AN ENTERPRISE ZONE IS EXPECTED TO BE REFLECTED IN THE TYPES AND SIZES OF FIRMS IT ATTRACTS. A REASONABLE MIX WOULD INCLUDE:

1. MAJOR PUBLIC INSTITUTIONS OR BRANCHES OF ESTABLISHED BUSINESSES TO SERVE AS ANCHOR TENANTS IN THE ZONE, EMPLOYING 200 OR MORE EMPLOYEES EACH
2. NEW ENTERPRISES IN A VARIETY OF INDUSTRIES, WITH ACCEPTABLE EMPLOYMENT GOALS
3. EXPANDING SMALL BUSINESSES WITH HIGH GROWTH POTENTIAL AND ACCEPTABLE EMPLOYMENT GOALS

EACH ZONE PROPOSAL SHOULD INCLUDE A PLAN FOR ATTRACTING A REASONABLE MIX OF THE ABOVE TYPES OF FIRMS; A PLAN FOR EFFECTIVELY MEETING A GOAL, NOT A QUOTA, OF 33 PERCENT OF THE FIRMS TO BE OWNED BY THE MINORITY GROUPS REPRESENTED IN THE SURROUNDING AREAS; AS WELL AS A PLAN FOR ASSURING THAT FIRMS CURRENTLY EXISTING IN THE COMMERCIAL ZONE WOULD NOT BE PERMANENTLY DISPLACED BY ZONE DEVELOPMENT ACTIVITIES. THIS PROPER MIX SHOULD FACILITATE THE POSITIVE BUSINESS AND NEIGHBORHOOD CLIMATE NECESSARY TO ATTRACT MAJORITY-OWNED HIGH GROWTH SMALL FIRMS AS WELL AS TO RETAIN MAJOR INSTITUTIONAL ANCHORS AND ESTABLISHED FIRMS. THIS MIX CAN FACILITATE AN ENVIRONMENT IN WHICH MINORITIES CAN INCREASINGLY BECOME THE EMPLOYERS OF THEIR OWN PEOPLE.

- INVESTORS IN MINORITY-OWNED ENTERPRISE ZONE COMPANIES SHOULD BE ALLOWED TO ESTABLISH LOSS RESERVES EQUALING 50 PERCENT OF THEIR EXPOSURE.

THIS PROPOSAL WOULD PERMIT INDIVIDUALS (THOSE FRIENDS, FAMILY MEMBERS AND ASSOCIATES WHO ARE THE MAIN SOURCE OF CAPITAL FOR NEW FIRMS) TO DEDUCT FROM THEIR TAXES A SPECIFIED PERCENTAGE OF

THEIR INVESTMENT IN ELIGIBLE FIRMS. TO GIVE AN EXAMPLE, A LAWYER WHO MADE A $10,000 INVESTMENT IN A NEW MEDICAL INSTRUMENTS COMPANY WOULD BE ABLE TO DEDUCT $5,000 ON HIS OR HER TAX RETURN. THE TAX BASIS FOR THE INVESTMENT WOULD BE DIMINISHED BY THE TAX DEDUCTIONS TAKEN IN CONNECTION WITH THE LOSS RESERVE.

- THE TARGETED JOBS TAX CREDITS (TJTC) SHOULD BE REFUNDABLE FOR ALL MINORITY-OWNED ZONE COMPANIES.

AN EFFECTIVE APPROACH TO REDUCING LABOR COSTS COULD BE TO MODIFY THE EXISTING TARGETED JOBS TAX CREDIT TO (A) MAKE IT REFUNDABLE FOR ANY MINORITY-OWNED COMPANY WITHIN AN ENTERPRISE ZONE, (B) REMOVE THE REQUIREMENTS THAT THE CREDIT BE AVAILABLE ONLY AFTER OTHER TAX CREDITS ARE USED AND (C) RESCIND THE REQUIREMENT THAT EMPLOYER WAGE DEDUCTIONS BE OFFSET BY THE AMOUNT OF THE CREDIT.

- THE INVESTMENT TAX CREDIT (ITC) SHOULD BE REFUNDABLE FOR ALL MINORITY-OWNED ZONE COMPANIES.

TO INCREASE THE CASH FLOW OF PROMISING BUT NOT YET PROFITABLE ENTERPRISE ZONE FIRMS, THE EXISTING TEN PERCENT INVESTMENT TAX CREDIT SHOULD BE MADE REFUNDABLE. TO DECREASE THE EXTENT TO WHICH THIS MEASURE WOULD REPRESENT A SUBSIDY TO INEFFICIENT FIRMS, A $100,000 CAP SHOULD BE PLACED UPON THE AMOUNT OF THE ITC WHICH WOULD BE REFUNDABLE TO ANY ONE FIRM.

- FEDERAL CRIME INSURANCE SHOULD BE EXPANDED TO INCLUDE SINGLE INSURANCE POOLS FOR ALL ENTERPRISE ZONE COMPANIES.

THIS WILL ALLOW FIRMS TO BE ASSURED OF BASIC INSURANCE COVERAGE AT REASONABLE RATES, AS WELL AS PROVIDE INCENTIVES FOR RATIONAL SECURITY PRECAUTIONS. FEDERAL CRIME INSURANCE CURRENTLY PROVIDES LIMITED COVERAGE TO RESIDENTS AND BUSINESSES UNABLE TO OBTAIN COMPREHENSIVE PROPERTY INSURANCE FROM PRIVATE INSURERS. ROBBERIES AND BURGLARIES ARE COVERED, HOWEVER, FIRE DAMAGE IS NOT.

I APPRECIATE THE OPPORTUNITY TO APPEAR HERE TODAY.

THANK YOU.

Notes

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2. Ibid.
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4. George Gilder, Wealth and Poverty (New York: Basic Books, Inc., 1981), p. 83.
5. David L. Birch, Choosing a Place to Grow: Business Location Decisions in the 1970s (Cambridge, Massachusetts: MIT Program on Neighborhood and Regional Change, January 1981), p. 25.
6. The New York Times, May 31, 1981.
7. Ibid.
8. White House Commission on Small Business Report to the President, America's Small Business Economy--Agenda for Action, (Washington, D.C.: Government Printing Office, April 1980), p. 34.
9. U.S., Small Business Administration, Office of Advocacy, Economic Research on Small Business: The Environment for Entrepreneurship and Small Business, Summary Analysis of the Regional Research Reports (Washington, D.C.: Government Printing Office, 1981) p. 98.
10. David Birch, "Generating New Jobs: Are Government Incentives Effective?" in Expanding the Opportunity to Produce: Revitalizing the American Economy Through New Enterprise Development (Washington, D.C.: The Corporation for Enterprise Development, 1981), pp. 10-16.
11. Mark Battle Associates, Inc., A Case for Government Support of Minority Enterprise, August 1981, p. 9.
12. Social Security Bulletin, Volume 43, Number 5, May 1980, p. 5.
13. U.S., Department of Commerce, Bureau of the Census, 1977 Survey of Minority-Owned Business Enterprises--Summary (Washington, D.C.: Government Printing Office, December 1980), p. 6.
14. Ibid., p.8.

JOB CREATION AND THE REVITALIZATION OF SMALL BUSINESS

WEDNESDAY, OCTOBER 14, 1981

House of Representatives,
Subcommittee on Tax, Access to Equity
Capital and Business Opportunities,
Committee on Small Business,
Washington, D.C.

The subcommittee met, pursuant to notice, at 12:10 p.m. in room 2359-A, Rayburn House Office Building, Hon. Henry J. Nowak (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN NOWAK

Mr. Nowak. The subcommittee will come to order.

We can now proceed with the witnesses, who have been very patient. We will start momentarily.

Today we continue our hearings on Job Creation and the Revitalization of Small Business. In hearings held last month, the subcommittee explored the impact of skilled labor shortages and the need for viable economic incentives for our older urban centers. With respect to the topic of today's hearing, small issue industrial development bonds are an example of an efficient tool which State and local governments have utilized for economic development.

Industrial development bonds provide low cost financing to private firms which might not otherwise be able to meet their capital formation needs. Often, the only alternative a business has for meeting its investment plans is to borrow from its local banker at interest rates which currently approximate 20 percent, although we have just seen yesterday a relief of 1 percent. Many small businesses just cannot afford to borrow at those kinds of interest rates and still maintain an adequate profit.

In my city of Buffalo, industrial revenue bonds have recently been instrumental in creating an estimated 2,500 jobs in the local area. This is especially significant at a time when Federal budget cuts will force many cities and towns to curtail community programs. The possible elimination of tax exempt IRB's would only exacerbate the problems States and localities face in their economic development plans.

Rumors of a proposal by the Reagan administration to eliminate IRB's have in fact surfaced this week. These rumors have caused widespread panic to occur in local communities and on Wall Street.

For example, fearing such a cutoff, city officials in Baltimore have rushed to prepare bills in the last 2 days, authorizing $692 million in IRBs. This is more than three times the amount of IRBs approved by Baltimore in all of last year.

The industrial development bond program should not be eliminated as a tool in economic revitalization, but, instead, should be strengthened. With this in mind, I welcome today's witnesses.

We will have, because of airline scheduling, a little change in the order, and our first witness represents the New York State Economic Development Council, George Cregg, Sr.

If you will come to the desk in front.

Mr. Cregg is a Certified Industrial Developer, and is in private law practice, and he is representing several local development agencies. The New York State Economic Development Council is the association for the various economic development authorities across the State. We welcome your testimony this morning.

Let me briefly state that the full text of your testimony will be inserted in the record, and you may proceed at your convenience, sir.

TESTIMONY OF GEORGE W. CREGG, SR., COUNSEL, NEW YORK STATE ECONOMIC DEVELOPMENT COUNCIL

Mr. CREGG. Mr. Chairman, I had rather short notice of the appearance here today, and I would appreciate permission to submit some additional testimony in writing.

Mr. NOWAK. Without objection, it is so ordered.

Mr. CREGG. My name is George W. Cregg, Sr. I live in Camillus, N.Y. I am a director of, and counsel to, the New York State Economic Development Council which is directly associated with the New York State Business Council.

Today, I officially represent the New York State Economic Development Council, and while the views I will state are in general agreement with the Business Council, the Board of Directors with the Business Council has not taken formal action on this matter up to this point.

On the other hand, the executive committee of the New York State Economic Development Council on October 7 at Rochester, N.Y., did take official action in the form of the following short resolution which states: Whereas, since the New York State Economic Development Council regards industrial development bonds as an important economic and community development tool to stimulate capital investments and employment at a time when Federal development assistance is being sharply reduced or eliminated, this financing mechanism must remain available to industrial development agencies in New York State, to the New York State Job Development Authority and to other public benefit corporations as a development incentive for private investment; and

Whereas we also recognize that legitimate concerns have been raised regarding abuse of small issue industrial development bonds, particularly those issued for commercial purposes.

Therefore, be it resolved that the New York State Economic Development Council recommends the following changes in Federal Legislation in response to that criticism:

One, target commercial IDB's to distressed areas by providing broad Federal guidelines within which States have the flexibility to determine the targeted areas based on State and local economic objectives.

Two, exempt from these restrictions special economic activities which are of particular importance to a specific State's economy and which encompass less than 5 percent of the State's economic base.

Three, exempt all production activities from research-processing to warehouse distribution from targeting limitation.

Four, establish Federal monitoring and annual reporting requirements by States for all small issue IDB's issued.

As an individual I have appeared before other committees and subcommittees of this Congress, and I have testified before with regard to industrial revenue bonds.

As the author of the New York State Industrial Development Agency Act, I have been closely associated with the issuance of IRB's in New York State since 1969 and as a member and director of the American Economic Development Council, I am also familiar with the issuance of IRB's in most of the other States of our Union.

I am now counsel to the law firm of Cregg, Storto, and Finlay, and we act as counsel to several issuing agencies and have represented numerous companies using the bonds and also purchasers of the bonds.

Industrial revenue bonds have proven to be the most effective tool to encourage the creation of jobs in New York State. Over $1.2 billion of these bonds have been issued in New York State and over 100,000 jobs have been created or retained through their use in New York State.

Only 25 percent of these bonds which have been issued in New York State have been issued for commercial purposes.

Twenty-five percent have been issued for pollution control, and about 50 percent, the balance, have been issued for purely industrial purposes.

These figures are rough, but they are reasonably accurate.

Please keep in mind that as our great Nation grows and matures, we are slowly moving from the original pure agricultural economy of our Nation through the world's greatest industrial economy, and into a third phase where service jobs are one of the most vital parts of our economy.

At this time we need to rehabilitate our industrial and commercial complex. Especially in the days of prohibitively high interest rates, we need to retain IRB's and encourage their use.

I have some figures available which are not in final form that I will be glad to submit to your committee.

Mr. Nowak. Thank you very much, Mr. Cregg.

Let me ask you a couple of questions. I am wondering, because of your familiarity with New York what kind of constitutional problems do you believe a State like New York would have if the IRB program required any kind of full faith and credit backing?

Mr. Cregg. Full faith and credit backing is available in New York State but only to the amount of $150 million and that is available to the job development authority.

That $150 million authorization has almost been completely used up.

There is on the ballot this November another proposed amendment to the New York State constitution that would permit a doubling of that amount or another $150 million. Even $300 million you can see, is a small drop in the bucket compared with the $1.2 billion that have been issued to date.

No other bonds can be issued for this purpose under either section 8 of article VII of the New York State constitution which regulates the State of New York and its activities, or section 1 of article VIII of the New York State constitution which regulates the municipalities of the State, the counties, cities, towns, et cetera. Under those sections and without the exception for the job development authority, it would be absolutely unconstitutional in New York to issue general obligation bonds for this purpose.

Mr. NOWAK. How would that authority, be developed in our State?

Mr. CREGG. In order to do that in our State we would have to go through two sessions of the state legislature and have the identical bill approved at two sessions, and it would have to be submitted statewide to a vote of the people.

Mr. NOWAK. It would have to be passed on both occasions?

Mr. CREGG. Yes, and a majority in the referendum.

Mr. NOWAK. For all intents and purposes, if that were a Federal requirement, you would have to have full faith and credit, New York State would be out of the business of industrial revenue bonds?

Mr. CREGG. Except for the job development authority.

Mr. NOWAK. Which is limited to that $150 million for the whole State?

Mr. CREGG. At the present time, yes.

Mr. NOWAK. Another proposal that has been mentioned would be a matching proposal.

I am not really sure exactly what that would mandate from a State, but generally, of course, it would probably be splitting of the obligation of the subsidies and the interest rate, and I am wondering what you thought about that as having potential?

Mr. CREGG. The same sections of the constitution that I cited with regard to the bonding would also apply, and the only funds that New York State or any of its municipalities have been able to pass along are funds which have their source from the Federal Government in Federal grants for any private purpose in New York State.

Mr. NOWAK. Thank you.

Mr. CREGG. It would be the same kind of disaster as the original proposal, Mr. Chairman.

Mr. NOWAK. Legislative initiative also has in it a proposal for a public hearing to be held before any issue could be made by any industrial development agency in the State or in any State.

What would your thoughts be on the advisability of holdings for each and every issue of every holding?

Mr. CREGG. Let me put on my developer's hat. The name of the game in industry is to deal in confidence, and if you cannot deal in confidence with industry, you are not going to do very much business with them because every industry, and every business in the United States, and it is very healthy that there is, is highly competitive with other industries, and they are not going to want to go to a public hearing with regard to the possible development of a proposed plan.

I firmly believe in public examination of records, but at the same time, it is vitally important to keep the private information of private companies away from their competitors.

When we file our income tax, no one else can look at our income tax, and the IRS should keep those figures to themselves, and it seems to me in dealing with industry that you are not going to be able to deal with industry and business, and encourage them to develop if you open them up every time you want to move and give them an invitation for them to come into your community, that you have a jurisdictionally required public hearing before you take any such action.

Mr. NOWAK. That would discourage an awful lot of interest in the program?

Mr. CREGG. Is seems to me for all practical purposes it would be a major stumbling block to using that type of financing.

Mr. NOWAK. Mr. Centner, do you have a question?

Mr. CENTNER. You are aware of the reasons for which we established industrial revenue bonds?

Mr. CREGG. Yes.

Mr. CENTNER. Have those reasons gone away?

Is there any less reason to have an industrial revenue bond than there was several years ago?

Mr. CREGG. I think there are additional reasons; if I may say, one of the things that industrial revenue bonds were set up to do was to create jobs, but I think in this competition, our competitive position that we are in with the rest of the world today, when some 70, 80, or 90 percent of our industrial and commercial complex is obsolete, we certainly should have major incentives that will bring about the rebuilding, rehabilitating and renewing of our industrial and commercial complex.

Mr. CENTNER. What percentage would you say of the bonds are abused?

Mr. CREGG. For those purposes?

Mr. CENTNER. We have been told there is an abuse of the bonds. Is it very much?

Mr. CREGG. My estimate would be something like a half of 1 percent.

This adult bookstore that is talked about in Philadelphia, I have talked to their development agency, and you people should talk to them, because that was not authorized by the City Industrial Development Agency. It was authorized by an agency outside the city of Philadelphia.

Mr. NOWAK. Excuse me, what agency was that, now that we are on this?

Mr. CREGG. The catch lines are things like fast food restaurants and adult bookstores and things like that. I don't care what kind of law you enact, somebody is going to figure out a way to abuse it. I can't believe it is any greater, than less than half of 1 percent.

Mr. CENTNER. It is silly to do away with 99.5 percent of the program if only half a percent is bad.

Why did you put that fourth point in the resolution? Why bother with Federal monitoring and lay out a reporting requirement that will probably require the States to hire new employees to do the reporting?

Mr. **Cregg**. This resolution does not fully agree with some of my previous testimony, but it is the resolution that was passed on, like all resolutions of all organizations, on a somewhat compromise basis, and there were people in our organization who felt that the Federal Government was justified in asking the States what had been done.

I don't know that that is going to be a prohibitively burdensome thing to do, because most States like New York are keeping a fairly accurate report available as to what bonds are issued in the State.

Mr. **Centner**. Could you reform the program with a little bit of abuse that is in it now without laying on this kind of requirement?

Mr. **Cregg**. I really don't think that personally, and I am not speaking as a representative of NYEDC; I hope that is a personal question.

I really don't think that there are these kinds of abuses, as you say. It seems to me that they are minimal.

The way some of these things have been handled in agencies that we represent in New York State, and I think it has happened in many other places elsewhere, is that the local agencies have adopted guidelines, and it is very difficult for me to believe that, with the people who normally serve on these agencies, that they would condone something that might be considered abusive, and in order to protect themselves, it seems to me that the way to handle that is to adopt local guidelines.

I think this resolution myself personally is a compromise of some of the thoughts of some of the members of the state association, but it is the official position of the executive committee at this point.

Mr. **Nowak**. Mr. Weber.

Mr. **Weber**. No questions.

Mr. **Nowak**. Mr. Cregg, when you say there may be more reasons today for this, and even when the program was first instituted, I wonder if, because of the EDA cutbacks and other Federal initiatives, we are going in a direction with a lot of crosscurrents?

We have just instituted the all-saver certificate which is going to provide tax-exempt interest for individuals, and I assume that we are hoping that that tax-exempt interest will be reinvested into industrial and productive business ventures, although many have doubts that that will occur.

If you could look at that program and compare it, as far as the total impacts, isn't this a much more direct way to stimulate our business growth in general communities, almost any area where these bonds have been sold?

Mr. **Cregg**. I have a tendency to hum "16 Tons" to myself, because I am inclined to think that the harder I work, the more money I owe to the bank, so I hope my banker friends won't be upset if I say that I agree with you.

I am very happy to see everybody get a break on this interest, and that they don't have to pay income tax on it, but it seems to me that this is a kind of a one-time shot and a very costly one-time shot.

I can understand it being done. I can understand the ramifications, but with this type of tax exemption, that is Industrial Development Bond financing, it stimulates additional jobs. It stimulates additional income, and there is a direct return.

We take a very firm position that the U.S. Treasury does not lose money by tax exemptions on industrial revenue bonds.

There have been several studies done to that effect, and I can make that information available to you.

Mr. NOWAK. Well, we will certainly hold the record open for that information. We are going to try to develop it with some other witnesses also, that there is a so-called revenue loss which is more than made up, when you consider all the other ramifications of a business.

If you can develop that, we would welcome that in addition to your other remarks.

Let me just thank you very much for appearing, and we will have additional questions for you, and hopefully, we will be able to pull the record together so we can interest some of the members on the Ways and Means who will eventually consider the question as to how to expand or curtail parts of this whole revenue bond sale opportunity. I want to thank you for coming.

Mr. CREGG. Thank you very much.

[Mr. Cregg submitted the following article:]

[From the Syracuse Herald-Journal]

TRIMMED: REAGAN CUTTING N.Y.'S BOOTSTRAPS

For nearly 20 years, New York State has been putting local and state government credit behind bonds to help job-creating firms add to an old plant or build a new plant.

The government-backed borrowing cheapens the companies' construction costs.

Eventually, the localities and the states recoup their expenses. Some even make money on the transactions. Losses have been minimal; in fact, the borrowings in this state don't cost taxpayers a cent.

But the Internal Revenue Service has thrown a curve. It is forbidding banks—which market these industrial development bonds—to merge small borrowings into million-dollar offerings, thus trimming selling expenses.

President Reagan is expected to take another limiting step, although "sales are booming," the Congressional Budget Office told Leonard Curry of the Newhouse News Service.

"All but three states actively use tax-free financing, providing interest subsidies for every kind of enterprise from manufacturing plants to country clubs."

In New York, the state, cities and counties issued $25 million of the bonds in 1974; they issued $252 million last year.

Consequently, the bonds have been abused, according to the CBO, financing franchise and retail chains, resort hotels and supper clubs, all capable of borrowing in regular money markets.

Further, since the issues are almost universal their impact on location decisions is minimized; although, assuredly, tax-free loans must encourage local employers to stay put.

The administration is headed toward "regulating" the bonds sought by franchisers and merchandisers. Industrialists could expect to get financing breaks.

Ironically, the coming reform is projected right after New York voters finally approved expanding the state's tax-exempt bonding authority to $300 million following two previous put-downs.

New York, along with the other states in the Northeast, needs every job-creating break it can engineer.

The president, we think, should return to square one and think again about banning tax-exempt financing for commercial enterprises.

They hire people and pay wages, too.

Mr. **Nowak**. Our next witness will be William Donohue, who is the executive director of the Erie County Industrial Development Agency. Mr. Donohue was formerly commissioner of community development for the city of Buffalo, and in 1978 he was named as the economic development coordinator for the county of Erie. He has been working with this program on behalf of the county since that time, and has been able to pull together many elements of the community for what many consider the model for the Nation.

It is a pleasure to have you here. Your whole statement will be in total submitted in the record.

TESTIMONY OF WILLIAM J. DONOHUE, EXECUTIVE DIRECTOR, ERIE COUNTY INDUSTRIAL DEVELOPMENT AGENCY

Mr. **Donohue**. Thank you very much. I have an abbreviated summary of that fairly lengthy statement which I would like to read to the assembled members.

My name is William J. Donohue. I am a resident of the city of Buffalo of the county of Erie in New York State.

The Erie County Industrial Development Agency is authorized to issue bonds under New York State general municipal law to enhance job opportunities in the State.

Based on our review of the Congressional Budget Office report, the ECIDA's IRB program in many ways parallels the experiences of the Nation as a whole but it also differs from many IRB programs in a number of important ways. First, agency efforts to promote IRB's are tied to an area strategy which defines target industries for retention and expansion. Seventy-five percent of our small issues in 1979 and 1980 were for firms in these targeted industries.

Second, the ECIDA has placed strict limitations on the use of IRB's for commercial projects. These restrictions are based on what we perceive to be a clear disparity between the economic benefits of commercial projects as compared to industrial projects; and they serve to allocate IRB's to the projects with higher net economic gains.

We believe that tax-exempt small issues serve as a powerful capital formation vehicle which can stimulate net new investment and jobs which might otherwise not occur. They have a positive impact on the amount of investment, the timing of investment location. Moreover, these impacts are most effective as they relate to investment decisions by new and small business firms.

IRB's offer clearly identifiable savings, which provide a certainty of benefits that reduces the risk to an investor and increases the probability of success for the venture. This is particularly important to high-risk projects.

Another important advantage of IRB's relates to the environment in which they are produced. The IRB process promotes close cooperation between the public and private sectors at the local level and provides an opportunity for linkage with other local and Federal programs of support and assistance.

We believe that the attempt to match the nature and quantity of the public subsidy in IRB's with the public benefits of these financings is a matter which is both important and overdue. We feel that the objectives of this process should be to reduce the drain on Federal resources by limiting the aggregate volume of tax-exempt issues and to direct the benefits of Federal subsidy to induce those projects with the highest possible economic yield. We suggest that revisions to current IRB procedures recognize and support two public purposes: First, to enhance the flow of capital to the small business sector; and, second, to assist distressed areas in competing for new capital investment and employment.

Numerous variations in eligibility, targeting, and size of issue can be devised to meet the purposes and objectives I have noted above. The following recommendations offer one workable alternative:

First. At the national level, restrict small issue industrial revenue bonds to industrial uses, including warehousing and distribution.

Second. With the exceptions noted below, retain the current capital expenditure limitation, and eliminate the $1MM clean limit small tax-exempt issue. This will reinforce small business capital formation benefits, while limiting the utility of small issues to branch operations of large firms.

Third. Designate target areas (SMSA's) on the basis of substantial and persistent unemployment. For projects within these areas, waive capital expenditure limitations, and increase the maximum tax-exempt issue amount to $20 million.

Fourth. Permit commercial revenue bond projects within these designated target areas, under the same terms as in the preceding paragraph, provided that it can be demonstrated that the commercial issue is an integral component of a federally sponsored redevelopment program. The ECIDA Policy and Procedures for Commercial and Recreational Project Revenue Bonds will be provided for review.

Fifth. If urban enterprise or job creation zone legislation is enacted for highly targeted, distressed, inner-city areas, maximum tax-exempt issue limits should be increased to $20MM.

I appreciate this opportunity to address you, gentlemen, and would welcome any of your questions. I also have a couple of comments I would like to make.

Mr. **Nowak**. Go right ahead.

Mr. **Donohue**. I notice in some of the comments that have come, supposedly the press acknowledges as having come forth from Treasury, that Treasury Secretary Chapoton is quoted as favoring a municipal contribution to the industrial revenue bond, and you alluded to that, by placing their credit behind such an issue.

At the same time, I think that many critics, and perhaps Treasury officials also have criticized the industrial revenue bond for reducing the spread between the industrial, excuse me, between the municipal GO bond and conventional financing, and that is exactly what would happen if the industrial revenue bond would be backed up by the full faith and credit of municipalities.

They are already having credit problems of their own. Bond houses find it much easier to evaluate the credit worthiness of a company than they do of a municipality. We all accept the vicissitudes of political life, and certainly the ability of a municipality to repay its general obligation bonds is dependent in large measure upon the many changes that can occur within a community, not the least of which is the attitude of the general public toward such expenditures.

My suggestion would be that if we wanted to really bring the industrial revenue bond to its highest and best use, we could probably eliminate at least 50 percent of its current usage by simply eliminating much of the commercial industrial revenue bond or the use of the industrial revenue bond for commercial uses, and second by eliminating the $1 MM clean limit small tax exempt bond. It is routinely used across the country and in many respects it lacks the aspect of inducement.

I notice in a recent article of Forbes of this past week, water, highway, bridges, gas, electric, hospital, housing, schools, and pollution control amount to better than $30 billion in tax-exempt financing in 1981. On the other hand, industrial revenue bonds will amount to $3 billion, at least as quoted in this article.

It seems to me the industrial development bond is a very small portion of whatever revenue is lost to the Treasury, if we should even talk in those terms, and second, that amount could be halved with a little bit of surgery in new legislation. Thank you very much.

Mr. **Nowak**. Thank you very much.

We are talking about $3 billion out of approximately $30 billion. And the $3 billion that we are talking about, of course, is that so-called lost revenue that the private sector, that is to benefit them, from the private productive sector.

You eliminate all the other so-called municipal uses. Whether schools, GO bonds or utility bonds, the only dollars that are really going into research and development or new products or expansion of a small business is the approximately 10 percent of those, so that proportion is very instructive.

If you took out, for example, just the one area of pollution, the control equipment, and you made that taxable, you would be saving twice as much revenue for the Federal Government, because that program is twice as big as the industrial revenue bond is, so we are putting the least amount of dollars into that subsidy, if you refer to it as such.

It seems to make little sense then to talk about expansion of the private sector and at the same time constricting any kinds of tools that are out there for that expansion to take place.

Let me take and try to elicit from you one of the arguments that has been proposed, all of this expansion in the private sector would have taken place even without any revenue bond sale on behalf of those corporations.

Could you, in your detailed working experience working with the companies that have used these bonds, what evidence could you give us to suggest that all of that development would not have taken place?

Mr. **Donohue**. I would tend to agree most commercial development would have taken place anyway, and I do look at the use of the bond for much commercial usage as an abuse.

That is not so true in New York State where only $1.2 billion in bonds have been issued over the past 11 years.

Pennsylvania issued that amount of bonding this year, and a large proportion of the bonding issued was for commercial uses; so we have all seen pretty strong evidence from the Congressional Budget Office that some companies, for example McDonalds and K-Marts, have taken advantage of this tool and abused it throughout the country. Some companies have a policy that they will not do an expansion without it.

Most of the large IRB projects, $18, $20, $50 million projects to which a $1 million clean limit tax-exempt IRB was tacked on, all of those projects would have gone ahead without IRB financing, whereas the industrial revenue bond has been used for small companies which aren't going any where but where they are now.

In many ways it has been a means of holding a company in the municipality it is now.

It might have gone to a more suburban or rural community with lower taxes and less crime within the State of New York.

More than likely, it would not have expanded or done anything, because it could not have afforded that amount of financing.

In many instances these bonds were packaged with other forms of financing, tax incentives from both Erie County, the city of Buffalo, and New York State which together enabled a project to go forward. In the last 3 years, we have really set our minds to marketing the IRB to about 600 small manufacturers.

We immediately doubled what we had done over the first 8 years in 1 year. We did $40 million in 1979, and we have continued to increase that amount each year.

Better than 75 percent of the firms were small companies and in most instances they would not have been able to go ahead, certainly this year, and last year at market rates; they could not have afforded their expansions.

Mr. **Nowak**. You mentioned targeting.

Do you believe that the local board that is put together in the various areas of the country should have the final decisionmaking ability as to who and what firms shall get, shall be the recipients of those sales?

Mr. **Donohue**. Personally I would prefer to see some kind of national indication.

The policy that we have adopted is that we will only do commercial bonds in distressed areas where the project is large enough to have a spillover effect. Generally, it is the first project in a given Federal redevelopment area.

There is an awful lot of room for collusion at the local level without some kind of policy indication from the Federal level. Perhaps enforcement can be ceded to the State level. I also believe that the Federal Government still has major urban and rural development programs and it is natural to assist them with this tool. You might want to consider some kind of a targeting mechanism which does that.

Mr. **Nowak**. You mentioned, I believe, and the other witnesses did too, the problem of getting the full faith and credit backing of the programs of the State of New York.

Do you feel the same way with the matching? How much success should you have if you had to match 50 percent of any revenue bond subsidy?

Mr. **Donohue**. Take a $2 million revenue bond with a 5-point spread over 15 years, the life of the bond, that might amount to $1,500,000; $1,500,000 to $2 million present valued. It would be very, very difficult for local municipalities to make up that kind of subsidy.

I can understand much of the legislation in the urban enterprise zone type legislation, your own bill, and that of Congressman Kemp where some kind of local commitment is required.

To subsidize the interest rate on the industrial revenue bond would be an incredible hardship on municipalities which are already in difficulty.

The city of Buffalo has a bond rating of BAA; the county has lost its triple A rating and now has an A rating.

This would curb local municipalities' outlays of GO bond expenditures needed to improve their infrastructure.

The older sections of the country, any older area of the country is facing major expenditures for the infrastructure.

New York State is proposing a $½ billion bond for prisons alone. We have got a couple hundred bridges which are badly deteriorated and unsafe.

As the Federal Government pulls away from Conrail, this will cause even greater pressure on local GO Bond capacity.

Mr. **Nowak**. Let me ask you one other thing. This committee has worked with the Committee on Economic Development in trying to put together an urban program, and you mentioned the Kemp-Garcia bill and others that have been filed.

Suppose there is a cutoff in EDA dollars. In fact, the appropriation for EDA is supposed to drop eventually from $265 million to $29 million. If all the cuts are put in place, would this be an additional reason, as far as you can see, for keeping this program in place, so at least some of the small business communities will have some access to funds at a lower than market rate, if you lose the ability to do that with the Economic Development Agency funds?

Mr. **Donohue**. It might be possible to make up through local resources, and particularly the community development block grant, some of the programs that will be eliminated or are threatened by the administration's reduced EDA funding. But there is no way to reproduce this tool.

This is the most effective small business capital formation tool that we have ever seen. I just don't know how you could substitute anything from any Government program that would have the effect that this program has had and that could be dispensed so easily with so little bureaucracy and yet with such a coming together on the part of local community on behalf of that business. It is so unbureaucratic. You can get an IRB closed in New York State in about 3 months. Most of the process occurs within the company and within the law firms, not within economic development agencies.

Mr. **Nowak**. I thank you.

Mr. Centner?

Mr. **Centner**. On page 2, I wonder if you would explain a term you used.

You have on line, starting on 6, "reduce the drain on Federal resources by * * *", I am missing that word.

Mr. **Donohue**. Limiting.

Mr. **Centner**. "To direct the benefits of Federal subsidies." What do you mean by Federal subsidies?

Mr. **Donohue**. Because that bond is tax exempt there is in effect a Federal subsidy.

Mr. **Centner**. There are a number of people who would be uncomfortable with the use of that term and disagree with it on the basis that it seems to imply that all the wealth belongs to the Government in the first place and anything they let you keep, you are lucky to have.

We would prefer to think of it as them confiscating less themselves, so the term subsidize——

Mr. **Donohue**. If that is a widespread interpretation, Mr. Counsel, and I would change my wording gladly because I certainly don't agree with that.

Mr. **Nowak**. Thank you.

Thank you very much, Mr. Donohue, your testimony and the submission, as we have gone over it, is very thorough, as usual, and I think you put this whole program in its proper perspective. Hopefully we can take your testimony and mold around it a kind of program that will be acceptable to the administration, and certainly hold this program together, so we can move forward in the areas on which you have testified which are so critical to new and starting developing companies.

Thank you very much.

[Mr. Donohue's prepared statement follows:]

PREPARED STATEMENT OF WILLIAM J. DONOHUE, EXECUTIVE DIRECTOR, ERIE COUNTY INDUSTRIAL DEVELOPMENT AGENCY, BUFFALO, N.Y.

The Erie County Industrial Development Agency was created pursuant to Article 18-A of the New York State General Municipal Law in 1971. The Agency has authority to issue bonds in pursuit of any of its corporate purposes including the promotion and development of industrial, manufacturing, warehousing, commercial, and research facilities, to enhance job opportunities in the State of New York. The ECIDA is one of approximately 150 industrial development agencies throughout New York State.

The Agency supports the continuation of small issue industrial revenue bonds as a means to promote increased small business investment and employment. To limit their growth and excessive costs to the Treasury, we urge that IRB's be targeted toward distressed areas and that stringent restrictions be placed on the use of IRB's for commercial projects. In conjuction with targeting and restricted commercial uses, we recommend that the maximum tax-exempt limit and capital expenditure limit be adjusted under certain circumstances.

Based upon our review of the recent Congressional Budget Office report on Small Issue Industrial Revenue Bonds, it appears that the history and growth of the ECIDA revenue bond program in many ways parallels the experiences of the nation as a whole.

From 1971 to 1978, the Agency issued 36 IRB's for a total of $39 million. In 1979 and 1980, 38 issues for $89 million were completed. This represents more than a 225 percent increase in volume of sales during a two year period. Through September 30, 1981 the Agency has issued 19 industrial revenue bonds totalling $36,440,000. Of the 37 tax exempt small issues in the 1979–80 period, thirty-one or 84 percent of the issues, were for less than $2.5 million. These represented 55 percent of total bond volume. Six issues in excess of $2.5 million accounted for 45 percent of total volume. Overall, the average amount of these issues was $1.69 million.

The first 9 months of 1981 showed ECIDA issuing 19 bonds, 17 of which were small issues for industrial projects with 1 pollution control issue and 1 commercial project representing the balance. Fifteen of these issues or 74 percent were under

$2.5MM. Fourteen of the 19 issues were closely held companies. Of the non-pollution control issues (18), the average issue amount was just under $1.5MM.

The 1979–80 IRB's issued in this period primarily benefited small, closely held coroporations in growth stages of development. Fifty-four percent of the firms had sales under $10 million and employment under 100 at the time of application. Of the remainder, 19 percent had sales between $10 and $50 million and 22 percent had employment between 100 and 200 individuals. Twenty-seven firms were for closely-held corporations, while only 27 percent of the firms assisted were publicly owned.

In 1981, 11 of the 19 bonds issues or 58 percent were for companies with sales of under $10MM and 100 or less employees. Of the remainder, 2 companies had sales between $10 and $50MM with the balance having sales of over $50MM. Thirteen of the nineteen had employment under 100 at the time of application, 2 had employment between 100–150 and the remainder had employment over 150.

The Buffalo area has a longstanding reputation as an economically declining heavy industrial area. Approximately 88 factories closed or curtailed operations in the period from 1969 to 1978, resulting in a loss of more than 30,000 jobs. Many of the facilities for heavy industry are old, inefficient and have high labor costs, making them uncompetitive with new plants, and particularly vulnerable to foreign competition. In addition, many of the markets served by Buffalo area companies have contracted or shifted away, and increased costs of transportation have made it more difficult for Buffalo firms to compete.

In the fall of 1978, the ECIDA adopted a Buffalo Area Economic Adjustment Strategy which set forth the roles of the major economic development agencies in the area and clearly defined targets of investment in terms of the types of companies to be assisted for retention and expansion. Target industries were selected on the basis of their national growth trends, as well as their match with regional assets.

Along with other federal and local incentives, industrial revenue bonds have been instrumental in local efforts to retain and expand targeted firms. Of the 36 revenue bonds closed for industrial firms during 1979 and 1980, 24 were in targeted growth industries while 4 were in industries identified for retention. In these projects, the small issue tax exempt bonds were largely responsible for inducing a net increase in investment and employment, and have contributed substantially to diversification of the regional industrial base.

Through 1980, the Agency closed only one commercial revenue bond. But at the present time, four issues totalling $13.6 million are pending. Each of these is an essential component of the City of Buffalo's Downtown Revitalization Program. They are in Urban Renewal Areas and are generally accompanied by Urban Development Action Grants.

Our experience leads us to conclude that tax-exempt small issues serve as a powerful capital formation vehicle which can stimulate net new investment and jobs which might otherwise not occur. They have a positive impact on the amount of investment, the timing of investment, and on the basic investment decision and its location. Moreover, these impacts are most effective as they relate to investment decisions by new and small business firms, which account for up to 86.7 percent of the nation's new jobs in the private sector.

Recent tax cut and business tax reform proposals have been promoted as a substitute for industrial revenue bonds and other direct and indirect federal subsidies. The ECIDA fully supports the proposed reductions in taxes as a means to renew the vitality of the national economy and to promote real economic growth. However, there are important differences between incentives based on the tax code and the advantages of industrial revenue bonds. By reducing the cost of capital and providing other clearly identifiable savings, tax-exempt IRB's provide a "certainty of benefits" which materially reduces the risk to an investor and increases the probability of success for the venture. By contrast, tax-based incentives are most effective when profitability is assured, and, therefore they have more limited capability to alter the investment decision for high risk projects.

A second advantage relates to the environment in which industrial revenue bonds are produced. The IRB process promotes close cooperation between the public and private sectors at the local level. This, in turn, creates a positive and effective medium for the incubation of company expansion plans. It serves to highlight the importance and public purpose of a company's contribution to the community, and it provides an opportunity for linkage with other local and federal programs of support and assistance.

During the rapid expansion of the Agency's IRB and other financial programs, it was important to allocate staff and financial resources to the highest possible priorities. The ECIDA actively marketed tax-exempt revenue bonds to targeted retention and expansion industries, and was able to sidestep many of the abuses which are common to other IRB programs and which have achieved notoriety in the media.

Specifically, the ECIDA has placed strict limitations on the use of IRB's for commercial projects in Erie County. These restrictions are based on the clear disparity between the economic benefits of commercial projects as compared to those of industrial projects. These differences relate to the number and quality of jobs created, as well as to indirect or spinoff effects. Commercial sector jobs tend to be lower paid and part-time employment, with less potential for career development. In addition, they generate fewer jobs per dollar of capital investment than the higher quality jobs of industrial projects. Also, input-output modeling has established that the spinoff benefits of service industry demand add a substantial level of economic benefit and employment to industrial projects. These benefits are greatly reduced, or entirely absent, in commercial ventures.

We hope that our experiences provide some assistance in your efforts to evaluate and reformulate revenue bond legislation. The attempt to match the nature and quality of public subsidy with the public benefits of these financings is both important and overdue. It is our view that the objectives of this process should be to reduce the drain on federal resources by limiting the aggregate volume of tax-exempt issues; to direct the benefits of federal subsidy to induce those projects with the highest possible net economic yield; to enhance the flow of capital to the small business sector; and, to assist distressed areas in competing for new capital investment and employment.

Numerous variations in eligibility, targeting, and size of issue formulas can be devised to correct deficiencies and to meet the public policy objectives noted above. Following is a series of specific recommendations which provide one such alternative:

(1) At the national level, restrict small issue industrial revenue bonds to industrial uses, including warehousing and distribution.

(2) With the exceptions noted below, retain the current capital expenditure limitation, and eliminate the $1MM Clean Limit Small tax exempt issue. This will reinforce small business capital formation benefits, while limiting the utility of small issues to branch operations of large firms.

(3) Designate target areas (SMSA's) on the basis of substantial and presistent unemployment. For projects within these areas, waive capital expenditure limitations, and increase the maximum tax-exempt issue amount to $20 million.

(4) Permit commercial revenue bond projects within these designated target areas, under the same terms as in 3 above, provided that it can be demonstrated that the commercial issue is an integral component of a federally sponsored redevelopment program. (The ECIDA Policy and Procedures for Commercial and Recreational Project Revenue Bonds will be provided for review.)

(5) If urban enterprise or job creation zone legislation is enacted for highly targeted, distressed, inner-city areas, maximum tax-exempt issue limits should be increased to $20MM.

I appreciate the opportunity to address this committee and assure you that the ECIDA will be available, as needed, to assist in your efforts.

Mr. **Nowak**. We would like to at this point call Myron Louik who is the assistant executive director of the city of Chicago Economic Development Commission.

The commission was created in 1976, hopefully to help business and industry build and expand and come into Chicago, and the commission is a partnership between the local government and the private sector.

We welcome your appearance here today on this very vital question, and again I would just tell you that the full text of your statement will be put into the record, and you may proceed as you desire.

TESTIMONY OF MYRON D. LOUIK, ASSISTANT EXECUTIVE DIRECTOR, ECONOMIC DEVELOPMENT COMMISSION, CHICAGO, ILL.

Mr. **Louik**. I will highlight a few of the points in my statement, and I have a few comments.

Chicago is very proud of the partnership as you expressed between the public and private sectors that occurs on the Economic Development Commission.

The commission is basically governed by a 29-member board, 19 of which are private sector members.

The commission has taken a very businesslike attitude toward the issuance of industrial revenue bonds, and since the inception of the program in Chicago which was in 1977, 71 bonds have been issued in excess of $140 million.

The commission until recently had basically refused to do what we would call any commercial project unless there was some special intervening reason, and that involved dislocation of companies because of public action or helping of minority businesses. In the interim the commission has recently approved a change which allows them to do commercial projects, but only in neighborhoods which are considered to be distressed, and there is a showing of positive impact on that neighborhood by the use of the commercial project.

Finally, I would like to just emphasize in our experience in doing the industrial revenue bonds, a considerable majority of those projects which have been approved would absolutely not have taken place within the city of Chicago. That is not to say that none of them would have occurred anywhere, but without any question, we would estimate in excess of 60 percent of the projects we have induced would not have taken place in Chicago.

They may have occurred somewhere else. Nothing may have happened, or the company may not have done anything.

Also, the overwhelming majority of our projects are for small businesses.

Again, we have found that we target and try to market this program to the local small business community that is there. We have a group of industrial representatives which call on in excess of 6,000 some small companies in the city. They have taken advantage of this program to expand their corporations, and for that reason we find it an extremely useful tool in creating jobs, because it is the small companies of this size, less than 250 employees, that are the prime creator of jobs, at least in the city of Chicago.

Mr. **Nowak**. Thank you very much.

[Mr. Louik's prepared statement follows:]

PREPARED STATEMENT OF MYRON D. LOUIK, ASSISTANT EXECUTIVE DIRECTOR, ECONOMIC DEVELOPMENT COMMISSION, CITY OF CHICAGO

Members of the Committee—My name is Myron D. Louik. I am the Assistant Executive Director of the Economic Development Commission of the City of Chicago. I appear today before you to present comments concerning the "small issue" industrial development bonds, especially as this relates to small businesses. The Economic Development Commission of the City of Chicago was created in 1976 to help business and industry build, expand, or relocate to Chicago. The Commission is composed of 29 members representing a partnership between local government and the private sector. Commission members come from major banks, retail and manufacturing concerns, labor, and various public officials. The Economic Development Commission is committed to: retaining and increasing employment throughout Chicago; stabilizing the financial base of the City's neighborhoods; and increasing Chicago's tax base.

In an effort to achieve these goals, the City of Chicago Industrial Revenue Bond Program has been available since 1977 to industrial firms seeking assistance in financing expansion or relocation projects in the City. In the first two years of the program in Chicago, very few projects were done. From January, 1979 to date, 71 projects totalling over $140,000,000 have been approved by the Commission. All of the 76 industrial revenue bond projects that the Commission has done have directly assisted in the retention of nearly 14,000 jobs over the past four years and are anticipated to result in the creation of over 6,000 new jobs. Most of this new private investment has been expended on new plant and equipment. We have taken an active interest in all our projects maintaining contact with companies for three years after bond closing for any follow up needs of the companies and for our own monitoring purposes.

The Industrial Revenue Bond Program has proved to be one of the most valuable tools available to us in our work to keep Chicago one of the nation's most vital industrial areas. The use of industrial revenue bonds as a means to access private capital markets appears to me to be crucial to the reindustrialization of America. It is imperative that we continue to encourage the private sector to invest in new plant and equipment.

Chicago's policies and procedures in terms of applying the use of Industrial Revenue Bonds are geared toward assuring successful results. The Commission has determined that industrial and primarily manufacturing projects provide the most appropriate vehicle for achieving the public purposes of employment creation and stability, business development stability and growth. All of these factors contribute to the maintenance of a healthy and viable tax base.

Relatively few commercial projects have been assisted by IRB's in Chicago. Commercial projects that have been approved include businesses which will undertake new construction in designated urban renewal areas of Chicago. IRB's have been utilized for companies that have requested relocation assistance due to City of Chicago condemnation action. Finally, IRB's have been approved to provide assistance to minority owned institutions. Recently, the Commission adopted a policy that will allow for commercial projects to be approved after the submission of a neighborhood impact statement which addresses the needs of the community and the impact both positive and negative that the project will have upon that neighborhood.

The Commission carefully screens all applications first through a screening committee of prominent bankers and financial experts to ensure the viability of the bonds so that even if the City of Chicago has no liability, the likelihood of any default is minimal so as not to even soil the name of the City of Chicago. Secondly, an application is reviewed by the Executive Committee of the Commission for conformance with policy guidelines. Finally, a bond must have 2 ordinances approved by the City Council of Chicago each of which requires a public hearing before their approval.

I would like to note that the Commission's interest does not end after an IRB issue is closed. We have instituted a monitoring procedure designed to follow the progress of each IRB project. Companies are contacted semi-annually for three years following the bond closing in order to monitor project completion and employment status. We have found that the majority of companies complete their projects within 12 months of bond closing and that overall company employment estimates have been met. A significant number of the new jobs created have benefited minorities.

While many of the nation's largest businesses are located in Chicago, there are also many of the nation's smaller, medium-sized companies. It is these growing middle-sized companies that most benefit from the bonds. Only 2 (2.6 percent) of the 76 companies assisted in IRB's have more than 1,000 employees in Chicago, while 64 (84.2 percent) of the companies had less than 250 employees. 28 or 36.8 percent of all projects approved were for companies with less than 100 employees. The size of the small companies ranged all of the way down to 12 employees. This particular company with 12 employees is the exclusive coater for McDonnell-Douglas Corporation and will have then doubled its size.

These small and medium-sized firms, through growth and expansion, provide the majority of the new jobs created, often provide the newest technological advancements and yet have the greatest need for capital. IRB's allow these companies to borrow at rates comparable to larger companies. By providing the means to access attractive financing, the companies are assisted in expanding in their neighborhoods. In Chicago, most of these industrial neighborhoods are pockets of industry located in the inner city. A stable neighborhood economy providing jobs for residents and contributing to our tax base is the result. If small issue IRB's were not available, the majority of this industrial growth would not occur. The expansion that would eventually take place would not be as large and from our experience, most likely would not occur in the geographic areas that need it most.

While the majority of IRB's in Chicago are already used by small companies, the Commission was studying methods of doing umbrella type IRB's so that even smaller companies could utilize the tax exempt financing vehicle. The Commission was looking at ways in which a pool of tax exempt funds could be utilized by the very small companies. Since the IRS ruling 81-216 has gone into effect, it does not appear that any umbrella or composite issue will be able to be done.

I feel strongly that in today's market small issue IRB's are practically the only method of financing projects for small businesses without some form of government guarantee. Therefore, there is a crucial need to continue to allow cities such as Chicago to utilize IRB's for both industrial and commercial projects for maintaining the vitality of our older cities and to allow small businesses in those cities the opportunity to grow and expand.

Mr. NOWAK. We talked about the possibilities of requiring States and/or local governments to back the IRB's with their own direct full faith and credit.

How would you envision this impacting Chicago?

Mr. LOUIK. I can't comment on the legal ramifications. I am not aware whether it is constitutional or not in the State of Illinois or the city to do that.

Fiscally it would be very, very damaging. The city's bond rating is an A bond rating, and I think that we would have, as a quasi-public agency that deals with the city and economic development, a very difficult time persuading the city officials that they should put their full faith and credit on this issue, especially when the bond rating has been at issue in different times and the additional bonds that would be outstanding with the city's name on it.

Mr. NOWAK. I understand you do have some type of hearing format for the IRB's?

Mr. LOUIK. Yes, we have two public hearings, once when there is an inducement ordinance passed, and once when the final bond ordinance is approved.

Just to comment on the use of the public forum, we have found no major problem with it.

There are certain companies whose financial records we screen and recommend to the city council, and they have asked that we maintain secrecy about those statements, and we adhere to that.

Other than that type of information, most of it is public information, and we have had no problems with companies refusing to go through the program because of public hearings.

Mr. NOWAK. Have privately held corporations requested that financial information be withheld from the hearings itself? Is that a problem?

Mr. LOUIK. No; they have taken the commission at its word. We have a screening committee composed of some of the top bankers and institutional people who look at these very closely, and even though the city of Chicago's liability does not exist with the bonds, we turn down applications which do not appear to be strong enough to amortize the bond over the life of the bond.

Therefore, when it comes time to have a council meeting, or when this is introduced, the fact that that screening committee has already approved that, there is strong indication that there is financial stability and they don't look to this financial statement.

Mr. NOWAK. You alluded to the necessity in the first place. Mr. Donohue talked about the crowding out of this when you compare the industrial revenue bonds with all the other bonds that are issued and public utility bonds, and the spread has become very narrow. I am wondering if the impact that you spoke about, the impact of encouraging an expansion is still true, even with the closing of the interest rate between the taxable and the tax-exempt bonds?

Do you see this as a problem in the future?

Mr. **Louik**. I would say the majority of the type of applications for financing that we see are set at a fixed percentage of prime which means, since they are floating, that impact is going to be felt through the life of the bonds.

Most companies find it is satisfactory to them to at least know they are paying some fixed percentage of the prime rate as opposed to a fixed rate that may not be advantageous to them. Since most of the applications have been floating-rate type proposals that have come in, the spread would not have much impact.

Mr. **Nowak**. If you were to look over last year's applications that you had, how many in terms of percentage of total dollar volume would you think would not have occurred, would not have been offered?

Mr. **Louik**. I would say we find several things. We find that there is probably about 60 percent that would not have occurred at all, at least within the city. Some of them would have occurred in the suburbs or moved out of State.

We know some companies stayed in the State because of the fact we did have industrial revenue bonds.

I would say approximately 60 percent of the bonds that we do would be of that nature. In addition, there would be 25 percent or more of the bonds in which the investment is substantially greater than would have occurred, that a company, instead of making a minor expansion will make a greater expansion and be able, instead of undertaking a $300,000 project, may be able to undertake a $500,000 or $600,000 project. We find that extremely valuable for the tax base of the city.

The $140 million that we have worked with, we would estimate over 75 percent of that has gone into actual real estate land and building improvements which then, of course, turn into tax dollars for the municipalities.

Mr. **Nowak**. Is there a similar organization to yours existing in an area outside of the city of Chicago?

Mr. **Louik**. No.

Mr. **Nowak**. Does the State have a development corporation that is also selling industrial revenue bonds?

Mr. **Louik**. Yes; a number of suburbs have home rule powers and may issue bonds on their own and some of them have.

The State has an industrial development authority which has the ability to issue bonds, and they in fact have issued several bonds within the city of Chicago. There have been cases where they have worked with a company that has maybe two plants in the State and is going to do some work on both of them, and they have done bonds within the city and somewhere else at one time or another.

Mr. **Nowak**. What about the impact of Revenue Ruling 81-216 that has come down, the million-dollar offerings? How does that affect you?

Mr. **Louik**. It has not affected us directly in that we have not used an umbrella or composite issue to date.

We have been trying to develop pool funds type of financing to help even smaller companies.

As a practical matter, we tell a company it does not make sense to do a bond with less than $500,000 and we were looking at ways to try to help some smaller companies which would need financing in excess of $100,000, maybe not $500,000, be able to package them together in order to make it salable, bonding would be advantageous to them.

Mr. **Nowak**. What is your front-end cost on a $½ million?

What is the front-end cost on a $½ million offer?

Mr. **Louik**. $10,000 or $15,000.

The State of Illinois had several of these umbrella issues in the pipeline and has had to pull back, based on this revenue ruling, they were about to try the composite.

Mr. **Nowak**. They were bundling, the State was?

Mr. **Louik**. Yes.

Mr. **Nowak**. Mr. Crane.

Mr. **Crane**. Sixty percent would not have taken place in the Chicago suburbs or elsewhere?

Why are you so sure that 60 percent would not have taken place in the city of Chicago?

Mr. **Louik**. Half of them without question were looking at other sites that we know about, with or without their knowledge.

One example was a local company looking in Indiana and they were under negotiations with an American Motors owned plant in Mishauaka in Indiana to purchase the building and we called upon them, how can we get you to stay in Chicago? We want you to keep your business here. They said, "We can't stay where we are. We don't own the building." After 2 months we came up with a proposal involving an IRD which enabled them to stay in the city.

Many of the industrial realtors would let us know when they have a prospect of a building in Chicago, when they have a company that wants to expand or buy a new building in the city and will come to us seeking help with the financing, and in many of those cases, they are looking in one of the other suburbs perhaps.

Mr. **Crane**. Did the workmen's comp, ever enter into that, because of the difference between the various States and Chicago?

Mr. **Louik**. Illinois workmen's comp, is one of the first things we hear about, although recent legislation has improved that. Over a period of the next several years, that was without a question one of the factors between, that was a factor and appears very much the differential between Illinois and Indiana as far as workmen's compensation.

Mr. **Crane**. You mentioned the commission has turned down many applicants who did not meet your standards.

Do you have any figures, approximate percentages, on how many you have turned down?

Mr. **Louik**. About a half a dozen altogether, so I would say it is a little bit less than 10 percent, certainly less than 10 percent.

Most companies or most people who try to do it utilize a partnership where it is a small, closely held corporation, some of the directors will form a small partnership to own a building or buy a building, and then lease it back to the company, and in most cases they know ahead of time whether they are going to be qualified.

One of the things we insist upon is the financial commitment from either a bank or lending institution or insurance company to purchase the bond.

Mr. **Crane**. You mentioned in your statement that, in the last 4 years, you saved about 14,000 jobs, have kept them in the city of Chicago, and yet since 1979 you have spent $140 million. Have you broken that down to show how many jobs were maintained in 1979 to the present?

Mr. **Louik**. That would be about 12,000 some, a little over 12,000 of those, almost 13,000 of those jobs in that period. In 1977 and 1978 there were only six bonds issued, and they had a total impact of a little bit more than a thousand jobs.

Mr. **Crane**. Thank you.

Mr. **Nowak**. Thank you, Mr. Crane.

Mr. Fary.

Mr. **Fary**. Thank you very much, Mr. Chairman.

First, let me apologize for my absence this morning.

I was chairing an important Public Works meeting. When I heard a fellow Chicagoan was here, I kind of burned the steps in getting up here.

Mr. **Nowak**. I accept your apologies if you will accept my apology for not being at your hearing this morning.

Mr. **Fary**. Even-Steven.

It has been rumored that the Reagan administration may propose ending the use of small issue industrial revenue bonds and try to force the States or local governments to pick up more of the cost by requiring local matching funds or some other restrictions on eligibility.

How would the Chicago Economic Development Commission react to this?

Would you be able to operate on your own with less Federal assistance?

Mr. **Louik**. The impact would be pretty devastating. As far as matching, I don't see how that could be done at all. I can't imagine where the funds to do any kind of matching would come from.

The bonds are one of the strongest tools that we have that are really being utilized by small businesses, especially the innovative businesses, the young, maturing businesses are providing the new jobs, expanding technology. The impact on them would be really devastating, especially in the city.

Mr. **Fary**. In your testimony you state that the industrial revenue bond program has proved to be one of the most valuable tools available to you in your work to keep Chicago one of the Nation's most vital industrial areas.

Can you suggest any other ways to encourage the private sector to invest in new plants and equipment?

Mr. **Louik**. Through the tax laws, some of the recent changes made in the Internal Revenue Code will stimulate investment in plant and buildings.

The major beneficiaries of that are still going to be larger companies, IRB's are one of the ways to help the small company take advantage of some of the tax laws, they still need to have the financing to be able to do that, and even with the prime rate dropping to 18, a small company is still going to be paying in excess of 20 percent or excess to borrow their money. They don't borrow at prime.

The industrial revenue bond does put them in a position of being able to finance a project relatively similar to a large corporation.

Mr. **FARY**. Won't it take the bigger companies a little more time to get in gear, in operation, so the little guy could catch up with him a little bit?

Mr. **LOUIK**. I think that, without question, some of the small companies don't have the redtape, they can move very quickly. They tend to move faster than the major corporations.

Mr. **FARY**. Could you give me some examples of what types of small businesses apply for these industrial revenue bonds in Chicago, and in addition, if you have this information what types of skills are required by their employees?

Mr. **LOUIK**. Let me pick a couple of the recent ones. We have a small company with 12 employees which we did a bond for $620,000 which will expand by 15, or more than double its size. They apply coatings to different types of plastics and to metals, and they are one of the major subcontractors for McDonnell-Douglas, and they have a very bright future, but now they are able to expand their operations by at least double.

We have a minority-owned Chinese food manufacturer who produces food for the institutional food service industry, increasing his employment from 28 to 38.

We have Hudson Technology, a high precision screw machine tool company, which may very well benefit from some of the increased outlays in defense spending, but they are going to be able to increase their size from 86 to 110 employees by building a 5,000-square-foot addition and buying new machinery and equipment.

There is a case of a company, highly technological, being able to buy the equipment to stay modern and compete with some of the foreign corporations.

In general, I would say many of those jobs skill training is required. We do training programs with some of the companies that have done industrial revenue bonds, so we can help train their employees for the different types of programs that they have, but within all of this, there are still a number of lesser skilled employees who are able to find work.

One of the other things also, in industrial-type projects you tend to get employees who make higher wages. We look for that in an application.

Most of the industrial jobs pay considerably better wages than do the commercial projects.

Mr. **FARY**. Thank you very much, Mr. Louik. Mr. Chairman, I am grateful to you for squeezing me in here on short notice.

Mr. **NOWAK**. No problem at all. We want to thank you and Mr. Crane for your interest in this problem.

Hopefully, we can develop some alternative to keep the program available. As we look at the impacts, along with the other crosscurrents that will be coming up in the new tax bill which I understand will be submitted by the administration, the specific proposals we have discussed, I think, will be part of that submission. We want to be able to have substantial input. We want to thank you for taking the time to come, because the agencies that are considering this, I think, look at one side of the equation and do not look at the total impacts that it would have. Unfortunately, sometimes I think we are going to go too far in our analysis of revenue executions and the definite areas where cuts could be made, and we want to have the other side present their views and give that input to the Ways and Means Committee.

Mr. **Louik**. I would like to recommend one study by Prof. Roger Kormendi. It is a good study of the impact on the Treasury, and the impact on the borrowing rates for municipalities and other general obligation bonds.

It is quite a good methodology. If you want copies, I would be happy to send you them.

Mr. **Nowak**. Fine.

[The study referred to above follows:]

THE NATURE AND EFFECTS OF SMALL-ISSUE INDUSTRIAL DEVELOPMENT BONDS

(By Roger C. Kormendi and Thomas T. Nagle, University of Chicago)

This study examines several issues related to the use of Industrial Development Bonds (IDBs). Much of the analysis and many of the conclusions in this study differ from widely cited studies by the Congressional Budget Office and the U.S. Treasury. Our purposes in this study are (1) to develop a more realistic view of the way capital markets adjust to small-issue IDB financing and (2) to derive estimates of the effects of IDBs that are consistent with this more realistic view. Our findings are the following:

The cost of IDB financing in foregone federal tax revenues is on the order of $4 to $6 million dollars for each billion dollars of new IDBs when taxable interest rates are in the range of 10 percent to 14 percent. These estimates contrast sharply with the CBOs recent estimates of $30 to $40 million for each billion dollars of bonds.

These revenue loss estimates imply that each dollar of interest saving for IDB borrowers costs the U.S. Treasury approximately 15¢ in federal tax revenues. Thus IDBs are more than six times as efficient as direct subsidies, which cost the U.S. Treasury one dollar for each dollar of benefit. This conclusion contrasts sharply with the Treasury's claim that each new dollar of interest saving for IDB borrowers costs the U.S. Treasury $1.33 in federal tax revenues.

The reason the widely cited CBO and Treasury figures are so inflated is that they are based on assumptions about investors' portfolio holdings that simply do not conform to the facts. Their analysis is equivalent to assuming that newly issued IDBs are absorbed only by investors around the 30 percent marginal tax bracket and that when those investors purchase tax-exempt bonds only fully taxable bonds are replaced. In fact, newly issued IDBs are generally absorbed by the full spectrum of investors above the 30 percent tax bracket, replacing in those investors' portfolios assets such as equity that, like tax-exempt bonds, are only partially taxed. The equity released by high tax bracket investors is in turn absorbed by the full spectrum of lower tax bracket households and non-taxed institutions in lieu of taxable bonds.

Inflation causes a shift of funds out of taxable bond markets into tax-exempt bond markets. This is because under current tax law taxes are levied not only on "real" interest income but also on that part interest income that simply compensates investors for the effects of inflation. Thus, funds that would otherwise be available for financing private investment through taxable bond and loan markets are diverted by inflation into tax-exempt bond markets, which traditionally have been the exclusive domain of public borrowers. The result has been a substantial reduction in tax exempt interest rates relative to taxable interest rates corresponding to the higher rates of inflation in recent years. IDBs offer the only currently available avenue for private investment projects to regain access to the funds diverted to tax-exempt markets as a consequence of inflation.

Tax exempt revenue bonds have often been alleged to disrupt tax exempt bond markets by significantly driving up tax exempt interest rates. One estimate that has been widely cited by both the CBO and the Treasury claims that each additional $1 billion of tax-exempt bonds would raise tax-exempt interest rates by 5 to 7 basis points. Our study finds that when lagged portfolio adjustments, the effects of inflation, and the integrated structure of capital markets are all properly accounted for, the effect of each additional $1 billion of tax-exempt bonds is only 0.6 basis points, or approximately one-tenth the widely cited estimate.

IMPORTANT FACTS ABOUT INDUSTRIAL REVENUE BONDS

The Congressional Budget Office (CBO) has issued its long-awaited study on small issue industrial revenue bonds. This study and testimony at the House Ways and Means Oversight Subcommittee hearings have produced some important findings about IRBs.

(1) By CBO's own estimate (CBO p. 45), the amount of federal revenue which could be raised by eliminating all IRBs as of July 1, 1981, would be only $0.2 billion in 1982, rising slowly to $0.7 billion in 1986. If all IRBs for commercial projects were eliminated, CBO estimates that only $40–$50 million of additional federal revenues would be generated in fiscal year 1982.

These numbers are vastly smaller than the gross CBO "revenue loss estimates" carried by the newspapers. These "revenue loss estimates" are misleading because they fail to take account of CBO's own estimates of increased investment, gross national product and federal tax revenues created by lower IRB interest rates.

(2) By CBO's own estimate (CBO p. 96), IRBs issued between now and 1986 will in that year produce over $4 billion of additional GNP, including $2.2 billion in increased private wages and salaries, enough to employ 150,000 people at an average wage of $15,000 per year.

Again by CBO's own estimates, this increase in jobs, private investment and income will be achieved at the "cost" of only $700 million to the Treasury, making IRBs the federal government's cheapest employment-producing program at less than $5,000 per job.

(3) But CBO's cost estimates are greatly exaggerated, as shown by testimony presented at the Oversight Subcommittee hearings by economist Roger Kormendi of the University of Chicago Business School. Adjusting the CBO's estimates to reflect more accurate assumptions, Mr. Kormendi found gross revenue "losses" of approximately one-sixth CBO's estimates.

If the CBO's estimated increases to GNP and federal tax revenues (CBO p. 45) are added onto these adjusted estimates, then the IRB program may actually be producing net revenue gains for the Treasury.

(4) CBO found that IRBs, though originally designed to lure industry to the South, have recently helped companies to grow in the Frostbelt. Two-thirds of all IRB sales in 1979 were for projects in the Northeast and North Central regions (CBO p. 27).

(5) CBO found that IRBs are overwhelmingly used by smaller companies. CBO reported that over 90 percent of the firms using IRBs in 1978 and 1979 were not listed on any national or regional stock exchange (CBO p. 21). Of some 8,000 small issues in those two years, only 7 percent went to the top "Fortune 50" non-industrial companies or the top "Fortune 1,000" firms (CBO p. 23).

(6) Despite increases in tax-exempt bonds to finance housing and industry, CBO notes that in recent years the difference between tax-exempt and taxable interest rates have widened from the historic 30% to nearly 40% (CBO p. 17). In other words, tax-exempt interest rates have not risen as rapidly as taxable rates despite the inflation of the past few years. Given this fact it is hard to claim that an increase in IRBs has substantially increased the cost of borrowing to state and local governments.

Mr. Kormendi estimates that each $1 billion of additional tax-exempts may raise the cost of state and local government borrowing by only six one-thousands of a percentage point—while also raising state and local tax revenues from the projects financed by IRBs.

(7) CBO's summary concluded that if Congress were to eliminate IRBs, "smaller firms would be the ones most affected. Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing" (CBO, p. xviii).

MASSACHUSETTS INDUSTRIAL FINANCE AGENCY

IRBS IN MASSACHUSETTS

Just six years ago, the Massachusetts economy was suffering badly. The state's unemployment rate was 50 percent above the national average, while personal income ranked third lowest in the nation when adjusted for our higher cost-of-living and taxes. In addition, our downtown commercial centers had deteriorated from a lack of private investment.

Today, however, Massachusetts enjoys an unemployment rate that has consistently been several points below the national average during the latest recession. The state has been vying with Texas for the lowest unemployment among the ten major industrial states. Manufacturers' capital investment in the state has increased 60 percent over the past two years, and personal income is rising at a faster pace in Massachusetts than the national average for the first time in a decade. Moreover, our downtowns are enjoying an economic rebirth as interest in urban development has been revived.

The responsible use of industrial revenue bonds (IRBs) for growing businesses and urban revitalization developments has played an important role in this dramatic turnaround. The Massachusetts Industrial Finance Agency (MIFA), has worked to help growing firms, especially smaller ones, to obtain low interest IRB loans. The agency has also made these loans available for commercial projects that contribute to the revitalization of the state's downtown commercial centers.

Some facts on MIFA:

In the past 2½ years the agency has approved over $750 million in IRB loans for over 500 growing employers who will add more than 25,000 new workers to their payrolls.

MIFA loans are primarily used for smaller companies. Of the industrial companies assisted by MIFA, one-half have annual sales of less than $5 million, and two-thirds have sales of less than $20 million. These companies do not have access to national credit markets for capital, and must rely on commercial and savings banks for their loans. In these times of volatile interest rates, these companies might not be able to expand without the lower IRB interest rate.

Massachusetts, unlike many other states, allows IRBs for commercial (as opposed to industrial) projects only if located in designated Commercial Area Revitalization Districts, primarily in the downtowns of our communities. These bonds have been critical to revitalizing many of our older cities and towns, and Congress has chosen to favor distressed areas by a special provision for IRBs used in conjunction with UDAG funds. Massachusetts ranks third in the amount of UDAG funds awarded to all states.

The $900 million of capital investment and 25,000 jobs stimulated by IRBs in Massachusetts have increased local, state and federal tax revenues.

The responsible use of IRBs has been extremely important in Massachusetts' economic resurgence, and any efforts to restrict IRBs nationally with a state by state limit must be defeated. In 1980 Massachusetts was the sixth largest issuer of IRBs in the country.

Mr. NOWAK. We want to acknowledge we have testimony for the record from Kutak Rock and Huie who were here earlier this morning. They had another appointment, but we will submit all their testimony for the record.

[Mr. Pell's prepared statement follows:]

PREPARED STATEMENT OF HAVEN N. B. PELL, PARTNER, KUTAK ROCK & HUIE, WASHINGTON, D.C.

Mr. Chairman, Members of the Subcommittee, I appreciate your invitation to appear this morning to testify on the subject of industrial development bond financing and its importance to our nation's small businesses.

I am a partner in the Washington, D.C. office of the law firm of Kutak Rock & Huie. For the past seven or eight years, I have served as bond counsel to a wide range of businesses seeking to begin or expand their operations and which have had to look for various sources of financing to achieve their goals and to create new jobs. One of the important options that historically has been available to small businesses has been the use of industiral development—sometimes called "industrial revenue"—bond financing through state or local governments.

This morning I thought it would be useful to discuss some of the elements of industrial development bond financing and explain how a company works with a state and local community to finance a new venture or an expansion program. In addition, I would like to share with you some examples of IDB financed companies which help illustrate the importance of maintaining this program. Finally, I feel it is important to review and respond to some of the criticisms of IDBs which have been raised by the Congressional Budget Office study released on April 1 of this year. In particular, I believe there has been a great deal of confusion over the types of companies which predominantly use IDB financing and a great overstatement of the cost which this program represents to the Federal government.

While critics of IDB financing have been quick to identify its use by a few large companies, it is important to recognize that this form of assistance provides an important source of capital to small businesses which in many cases would be unaffordable or unavailable. In dwelling on the use of IDBs by a few large companies, CBO has obscured the point made in its own survey that 93 percent of the IDBs issued in 1978 and 1979 went to firms which are outside of the Fortune 1000 rankings.

In addition, we should not lose sight of the fact that IDB financing has served as a vital planning and business development tool for state and local governments. States across the country have found that IDBs represent a Federal program with no Federal bureaucracy which can be used to meet their individual economic needs whether those are helping new companies with financing start-up costs, assisting existing companies in expansion programs, or providing sources of capital to finance business growth that is needed to service new energy development and population centers. Our law firm has been fortunate to work with a number of these states and local governments in the productive use of industrial development bond financing.

As you know, the ability of state and local governments to issue general obligation and revenue bonds was recognized by Congress as early as 1913 when the first income tax was enacted providing that interest on those obligations would be exempt from Federal taxation. The State of Mississippi was the first to inaugurate the use of revenue bonds to encourage industrial and manufacturing development and to generate new jobs. Since Mississippi first enacted legislation in 1936 authorizing the use of IDBs as a source of credit for encouraging economic development, 46 other states have joined in the adoption of similar programs at the state or local level.

The tax exemption for industrial development bonds is a part of Section 103 of the Internal Revenue Code. In 1968, Congress modified this section and created different categories of projects which would be eligible for tax exempt financing. Among them are the small issue industrial development bonds which state or local governments can issue for the purchase of buildings or depreciable equipment to be used by a company locating within the state or local jurisdiction. Two categories of small issues were established—one for projects which involved a total capital expenditure of more than $5 million during a six-year period beginning three years before and ending three years after the approval of the IDB. A separate small issue bond was established at $1 million or less which carries fewer limitations. Congress raised the $5 million capital expenditure limit to $10 million in 1978 in order to adjust for the effect which inflation has had on the cost of constructing business and manufacturing facilities. In addition to the small issues, Congress authorized the use of IDBs to help finance the purchase of pollution and solid waste control facilities, and the construction of ports, docks, airports and certain energy generating facilities, among others.

Perhaps it would be useful to discuss the unique partnership which occurs when a state or local government and a business work together to help secure financing for a start-up or expansion program. First, the business and the local development agency often enter into preliminary discussions regarding the need for capital to allow the company to start a new manufacturing process, for example, within the local government's jurisdiction. Frequently the agency will conduct an initial review of the nature of the project, the product to be produced, and the number of new jobs to be created, and then issue an "inducement resolution" indicating its intention to issue an industrial development bond to secure the needed capital if the company builds a facility in its community.

The second step involves the preparation and negotiation of the legal documents necessary to complete the financing, and the third step is the marketing of the bonds to investors by an investment banker. In many instances, though, the bonds are placed with a bank in the form of a loan. Finally, the documentation necessary to close the transaction is assembled and signed, bond counsel renders its opinion that the bonds are validly issued and the interest is exempt from Federal income taxation and the transaction is closed. It is the tax-exemption which allows the bonds to be offered at interest rates below those for conventional financing, thus lowering the cost of raising capital to the business. In the past, the spread between tax exempt and conventional financing rates has been as low as one and one-half to two percent. During the past three years, however, the spread has grown as conventional interest rates rose to more than 20 percent.

One specific example of a financing in which I was involved was a $4.3 million issuance of industrial revenue bonds by the city of Chicago to finance a new bank building for the Independence Bank of Chicago. The Independence Bank of Chicago is a minority-owned bank located on the South Side. It has experienced fairly substantial financial difficulties in the past due, in some measure, to its absorption of other minority-owned banks to keep them from being liquidated because of insolvency. Increased bank activity, resulting in part from the merger of these other banks into Independence Bank, made it necessary to construct a new building for Independence, but no financing was available. In a very sophisticated transaction, the bonds were collateralized by certain low interest rate GNMA securities held by the bank and the interest rate on the 22-year bond issue was 8.70 percent, probably half the rate that would have been available at that time using taxable financing.

As a result of this financing, the city was able to help in the construction of a new building and permit a small locally-owned banking institution to continue to provide for the financial needs of the retail stores and other service businesses located in this South Side community.

Needless to say, while access to affordable capital formation may be very important to a larger company, it can be critical to the success or failure of a small business. Larger companies often have a number of means available to them for raising capital, from the issuance of additional stock to their ready access to major lending institutions. On the other hand, small businesses generally do not possess the kind of clout it takes to negotiate a loan at several points below the prime rate. More often than not, if they must seek conventional forms of financing, they must pay as much as two points above the prime rate. Furthermore, it is not at all unusual to find credit simply unavailable to the small company when interest rates continue to hang at unprecedentedly high levels and banks become increasingly careful as to the risks they will take on any single loan.

We have learned from several state development offices, like the Massachusetts Industrial Finance Agency, that businesses frequently approach their agencies after virtually exhausting their sources in the conventional credit markets. The state agencies in many cases offer the only source of financing to these companies.

In some instances, the availability of industrial development bonds has been the central factor in saving an existing small business from being liquidated. Perhaps one of the most dramatic examples occurred in neighboring Baltimore. A year ago next month the Parks sausage company will complete its first year of successful operation after almost going out of business. Of particular importance is the fact it would not be in business today without the assistance of industrial development bonds.

Parks was founded more than a quarter of a century ago by H. G. Parks. He built the company into one of the top 10 minority-owned firms in the nation and then sold it four years ago to the Norin Corporation of Miami. Sales began to slide under the new ownership and the company experienced its first loss a year ago. Canadian Pacific Railroad later acquired Norin and decided to sell Parks because sausage manufacturing didn't fit with Canadian Pacific's long-range corporate plans.

Park's employees were given first refusal rights to buy the company but only 45 days to come up with the financing to buy the operation for $4.6 million. The company's president, Raymond V. Haysbert, who had been with Parks for a number of years, put together a group of employees who were able to raise nearly half that amount from a variety of personal and business loans, and then came up with the balance when the City of Baltimore issued $2.4 million in industrial development bonds. The company began operation under the new owners on November 17, 1980. After four years of declining operations, sales rose 12 percent in the last quarter, and the company expects to reach an annualized rate of $17 million in sales this year bringing it back to its previously successful level of operation.

Of equal importance is the fact that the rejuvenation of Parks saved 234 jobs and it helped return control of a Maryland enterprise to a Maryland Company.

Our firm has worked with development directors in almost every state and recently surveyed them for other financing experiences in an effort to demonstrate the importance of IDBs to small businesses which, as this Subcommittee knows, represent 97 percent of all businesses in the country and which create the great proportion of new job opportunities for American workers.

Among the other examples discovered in our survey was one which involved the recovery of the city of Wilkes-Barre, Pennsylvania from the 1972 flood caused by Hurricane Agnes. At the time of the hurricane the downtown area of Wilkes-Barre was in a state of economic decline, and the flood destroyed the 45 percent of the city which constituted nearly 70 percent of its tax base.

While assistance from the Federal and state governments was essential in restoring the damaged infrastructure of the city, local developers had to look to the industrial development bond program to secure financing for an industrial and commercial development plan which Wilkes-Barre IDA Executive Director, Joseph A. Williams, described as "the salvation of Wilkes-Barre City and Wyoming Valley." Williams told us that, "Tens of millions of private dollars have been spent on acquisition and startups in abandoned factories and stores and on the construction of new buildings and expansions of others. Thousands of our skilled workers have been employed accomplishing these changes and other workers, both skilled and unskilled, now enjoy employment which otherwise would not have been available to them." Williams went on to cite several examples of companies assisted with IDB financing such as the Metropolitan Wire Company which is consolidating its operation there and projecting the creation of 425 new jobs made feasible by an IDB loan for new machinery; and the Wilkes-Barre Inn, a local firm which on the strength of an IDB issue of $4.8 million erected a hotel which provides employment for more than 200 people, most of them unskilled.

There are thousands of other less dramatic examples around the country where small businesses employing as few as four people have been assisted by loans often as small as $20,000

One of the difficulties which we have experienced this year in attempting to develop a comprehensive record of the positive uses which have been made of industrial development bond financing is the lack of a state-by-state record compiled by state and local industrial development agencies. Virtually everyone who has examined the issue of IDB financing during the past year has agreed on one point—there is too little information in the public record about how IDB financing has been used, and correspondingly there is a need for state and local governments to adopt uniform reporting requirements in order to provide a better picture of how this community development tool is operating.

For example, until the Congressional Budget Office issued its study of IDB financing in April, no Federal or state agency or Congressional Committee had attempted such a comprehensive examination of the uses of industrial development bonds. And while CBO spent more than a year in compiling its figures and researching questions about IDB financing, its final document generated a considerable amount of controversy.

While I would tend to agree with Senator Ted Stevens of Alaska, who told the Senate Small Business Committee last week that he believed that CBO had done a good job in the study of IDBs, I would also agree with his conclusion that the study seemed to focus more attention on IDB abuses rather than on the public benefits which have been garnered by the issuance of the bonds. Nevertheless, the CBO study has become a focal point in the debate over IDB financing. For that reason I would like to bring out some of the important points which it makes about the benefit IDBs; provide to our nation's small businesses and then go on to raise questions about the conclusions the study makes about projected revenue losses and other questions associated with IDB use.

While much of the recent public debate has revolved around the appropriateness of some IDB financed projects for a relatively small number of large corporations, it is essential to keep in mind that the overwhelming number of IDB users are small businesses. As I noted earlier, the CBO study tells us that of some 8,000 small issues approved in 1978 and 1979, 93 percent went to companies which were outside the top Fortune 1,000 industrial firms or the top Fortune 50 nonindustrial companies. The CBO study goes on to say, "In terms of both the number and volume of issues, [IDBs floated to assist large corporations] constitute a small proportion of small issue sales." Even "in terms of the dollar volume of sales in 1978 and 1979 only 16 percent was for Fortune 1,000 or Fortune 50 companies."

"The $10 million capital expenditure limit effectively keeps most large corporations from making much use of small issues," CBO said.

At a time when the Administration is seriously considering the restriction or elimination of industrial development bonds, it is even more important to note the conclusion of the CBO study as to what effect such a decision would have on small businesses.

"If small issues were banned and no other program funds were substituted for them, some investments would not go forward. The primary effect of a ban would probably be on the allocation of capital, rather than on the overall level of investment. Since small issues make more capital available to small and medium-sized firms and to companies that are extremely sensitive to interest rates, it follows that these would be more affected by the elimination of the tax exemption.

"State programs to help smaller and riskier businesses would also suffer from a ban on IRBs. Specifically, if a state . . . provides funding under umbrella loan programs [for small businesses] . . . it would have to discontinue or modify its activities," CBO said.

Unfortunately, the CBO conclusions regarding the impact which the elimination of IDB financing would have on small businesses are not the ones which you find quoted most often. In fact there are a number of features concerning IDBs which can be cited in strong support of not only the continued use but of the expanded use of industrial development bond financing. For example:

1. Industrial development bonds do not require any Federal bureaucracy to administer them. In fact they are an excellent example of the new federalism which has become a hallmark of the present Administration, because they offer a means by which state and local governments can assume greater responsibilities for community and business development without the intrusion of Federal red tape, regulations and reporting requirements.

2. IDBs offer states and local governments an important tool for helping to shape the direction of community economic development. CBO suggests that IDBs duplicate existing Federal programs such as the Economic Development Administration, the Comprehensive Employment Training Act, the Urban Development Action Grant program, the Small Business Administration grant and loan programs, and the Farmers Home Administration business and industrial loan program, without noting that these programs have been severely cut back or slated for repeal under the Administration's economic program. IDBs, in fact, are one of the few remaining tools available to aid in local economic development.,

3. In addition to the importance of IDBs in providing low-cost loans to businesses, the program is one of the most efficient means for the creation of new job opportunities. Even if you use CBO revenue loss estimates to determine the federal "cost" for each job created or saved by an industrial development bond, the actual Federal revenue loss for new jobs created by IDB-financed projects would represent a small fraction of the cost of a CETA program job. The price of an IDB job even falls well toward the low end of the cost of the targeted income jobs credit, which is estimated to range between $900 and $2,580 per year. Unlike many job creation efforts, IDBs generally create permanent jobs and permanent additions to the tax base through the construction of new facilities.

Now let us review some of the more negative assertions in the CBO study, such as statements that:

1. IDBs constitute a drain on the Federal Treasury.

2. The volume of IDB financing has grown dramatically to an estimated $8.4 billion in 1980 and is out of control.

3. Large corporations may avail themselves of unlimited amounts of tax exempt financing and that the bonds have been a boon to national retail and other firms which require relatively low capital expenditures for each facility.

If we examine each of these assertions carefully we discover quickly why they have generated so much controversy throughout the country.

With regard to projected revenue losses, the CBO study stated on its opening page "that the Federal revenue loss will amount to approximately $1 billion in fiscal year 1981, rising to between $2.9 billion and $4.4 billion in fiscal year 1986." Let me point out that these estimates are the tax revenues which CBO believes will not be collected because the investors who purchase IDBs do not have to pay taxes on the interest earned from the bonds. It is not until page 40 of the CBO study, however, that it is explained that in order to raise these large revenues, Congress would have to repeal retroactively the existing tax exemption on the nearly $40 billion worth of IDBs which have been issued over recent decades. No one, including CBO, has ever suggested such an unprecedented action.

Later on in its study, however, CBO said that a July 1, 1981 repeal of the small issue exemption for all IDBs would raise no new taxes in fiscal year 1981, $300 million in 1982 and $1.8 billion in 1986 for a total of $5.3 billion in five years.

After criticism was directed at the revenue estimates included in earlier drafts of its study, CBO agreed to modify its figures to take into account the additional taxes which economic activity created by IDB financed projects would generate. When CBO revised its figures allowing for this feedback effect, it found that the revenue gain from eliminating all small issue IDBs would only be $200 million in 1982 and would rise to only $700 million in 1986, for a total of $2.5 billion in five years—less than half the other projection.

There is every reason to believe that even the revised CBO estimates are too high. For example, Dr. Norman Ture, now the Undersecretary of the Treasury for Economic and Tax Affairs, estimated last year in a study he prepared as a private consultant that the IDB small issue exemption could make money for the Treasury even if its limits were substantially increased.

Dr. Ture pointed out that if IDBs were eliminated, a corporation would have to obtain financing at higher, taxable rates. The additional interest which it would have to pay for taxable financing would represent a new tax deduction by the corporation and therefore reduce its tax liability. Ture concludes therefore that CBO's revenue loss estimate is 40 percent too high because of this omission. CBO simply stated that, "Because of the uncertainties involved in estimating this offset, it is not included in the CBO revenue loss estimate."

Dr. Roger Kormendi, a leading expert on municipal finance at the University of Chicago, also believes that most money invested in IDBs would shift to other sheltered investments if IDBs were eliminated and not into largely taxable investments which is the basis for the CBO projections. As a result, Dr. Kormendi estimates that the revenue loss to the Treasury is six or seven times less than what CBO has estimated and that each dollar of interest saved for an IDB financed company in fact costs the Federal Treasury only 15 cents in tax revenues—a sharp contrast with previous Treasury claims that each dollar saved costs the U.S. Treasury $1.33.

With respect to the CBO emphasis on the growing volume of IDB use, it should be noted that CBO in pointing to an estimated total of more than $8 billion worth of IDBs issued in 1980 failed to account for the fact that inflation would reduce that figure by at least one half in 1970 dollars. In addition, IDB financing has become increasingly more attractive as conventional interest rates soared to more than 20 percent. Many groups have argued in fact that the present financing limits should be increased from $10 million to $15 million in light of the fact that a plant which could have been built for the $5 million limit first enacted in 1968 would today cost more than $14 million.

As to those critics who have suggested that IDBs are an uncontrollable tax incentive, they seem to overlook the fact that it is the only such provision subject to any form of government approval before it may be used by a company. No one examines the purpose for which the investment tax credit is to be used before a company can buy equipment, or whether a company's buildings or equipment are eligible for accelerated depreciation. Yet a state or local government body must approve every IDB that is issued.

Finally, we return to the repeated assertions that IDBs are somehow being disproportionately used by large corporations. The best responses to this argument however, are contained in the findings of the CBO report itself.

In its section entitled "Patterns of Corporate and other Business Use" CBO says, "Since the early 1970s, most small issue IRB financing has . . . primarily benefited small and medium sized companies. For example, of the projects approved by the New York City Industrial Development Agency between January and November 1979, more than three-fourths were for companies with net annual sales of less than $20 million, and more than half of these projects were for firms with net annual sales of between $1 and $5 million. Similarly, more than three-fourths of the IRB-financed manufacturing facilities approved by the Massachusetts Industrial Finance Agency (MIFA) in 1978 and 1979 were undertaken by companies with annual sales of less than $20 million . . . . These figures seem to reflect national practices," CBO said.

If further evidence is needed of the importance which state and local governments, as welll as small businesses, attach to the use of industrial development bonds, it can be found in the reaction to an Internal Revenue Service ruling No. 81-216 which was issued by press release on August 24, 1981 without any public notice or consultation with any governor, mayor, or Member of Congress.

That ruling, as most of you are now aware, terminated the programs which 32 states now operate to provide low-cost loans to small businesses and farms. While IRS later announced that it would be flexible about applying the new ruling to projects in the pipeline, and even later was forced to withdraw the ruling while Treasury sent up a proposed regulation in its place, the precipitous announcement sent a shock wave throughout the country. The governors of all 50 states, through their four regional governors' associations, have called for the withdrawal of the ruling, and I understand that a number of Members of Congress and Senators have signed letters to the President asking for its postponement or withdrawal as well.

Many of the governors, if not most, have expressed a willingness to support the Administration's economic programs, even when it meant significant sacrifices in programs on which they have been dependent. However, they argue that they as the Federal government closes down program after program which they have used to generate economic development, that the states must continue to retain the development tools which they historically have had available to them along with the flexibility to use those tools effectively. Many governors have even suggested that it is ironic that an Administration committed to the rejuvenation of our Federal system would at the same time it is shifting more responsibility to the states deny them the mechanisms they now need more than ever to shoulder these new burdens.

Mr. Chairman, your Subcommittee is performing a valuable service through these hearings in calling attention to the important uses to which small businesses and state and local governments have put IDB financing. I am familiar with your long standing interest in this subject and the legislation which you have offered in this Congress. I applaud your interest and support.

I would like to close by endorsing the comments made only last week by Senator Stevens in his testimony before the Senate Small Business Committee. He said, "Small issue IRBs are one of the best opportunities that the Federal government can provide to state and local governments to fashion their own economic development. Today, we are cutting back on direct Federal aid to state and local governments in a painfully short period of time. Our message to local governments seems to be a clear one—you will have a greater responsibility for taking care of your own local problems." Under these circumstances". . . the worst possible thing you can do is to take away industrial revenue bonds. They're one of the few tools cities and states have at their disposal to take economic devastation and turn it into economic development."

That is a statement with which I believe we all could agree. Thank you.

Mr. NOWAK. We had another organization that wanted to testify from Louisiana, and that is McCollister, McCleary, Fazio, Mixon, Holliday, and Hicks, and I would like to read for the record the letter that we did receive this morning, it states:

Dear Congressman NOWAK: It is with sincere regret that I must notify your office that I will not be able to appear before your subcommittee on Wednesday, October 14, 1981 to testify on the subject of Small Issue Industrial Development Bonds. The continuous flood of rumors in Washington and on Wall Street in New York concerning the pending threat that legislation will be introduced this week to kill Small Issue Industrial Development Bonds has caused several of my major clients to call special meetings on Tuesday, Wednesday and Thursday in Louisiana for purposes of being brought up-to-date on this very vital matter. These meetings will require me to remain in Louisiana.

The State of Louisiana has effectively and intelligently utilized Small Issue Industrial Bonds for the economic and industrial development of the State. As General Counsel to the Louisiana Public Facilities Authority, I am extremely interested in having an opportunity to provide input to your subcommittee on this subject. I sincerely hope that I will have the opportunity in the near future to appear before your subcommittee in the event you elect to hold additional hearings on this very important matter.

Sincerely yours, McCollister, McCleary, Fazio, Mixon, Holliday & Hicks, Steve E. Hicks.

We will certainly hold the record open to receive additional testimony. We want to thank all the witnesses and the other members for attending.

We are going to condense these hearing records into a report which we will make available to the Ways and Means members, and hopefully find some area of compromise so that the best parts of this program can be withheld. I think that many will agree, this revenue will be a false economy in the fight to lower the deficit. Thank you very much. This meeting is adjourned.

[Whereupon, at 12:40 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

[Statements subsequently received follow:]

[JOINT COMMITTEE PRINT]

BACKGROUND
ON
TAX INCENTIVES
FOR EMPLOYMENT

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC GROWTH,
EMPLOYMENT, AND REVENUE SHARING

OF THE

COMMITTEE ON FINANCE

ON APRIL 3, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Subcommittee on Economic Growth, Employment, and Revenue Sharing of the Committee on Finance has scheduled a hearing on April 3, 1981, on the use of tax incentives to increase employment.

This pamphlet, prepared in connection with the hearing, contains three parts. The first part discusses the legislative history of tax incentives for employment, beginning with the WIN tax credit as adopted in 1971. The second part describes the present targeted jobs tax credit and WIN tax credit. The third part provides data on recent use of the credits and summarizes several recent reports evaluating the credits.

I. LEGISLATIVE HISTORY

A. Employment Tax Incentives Prior to the Revenue Act of 1978

1. Work incentive program credit and welfare recipient tax credit

As part of the Revenue Act of 1971, Congress adopted a tax credit for the hiring of recipients of Aid to Families with Dependent Children (AFDC) who were placed in employment through the Work Incentive Program. The amount of the credit was 20 percent of the gross wages paid to the employee for the first 12 months of employment (whether or not consecutive) during a period of 24 months from the first day of employment. The maximum amount of credit which could be claimed by an employer, in any taxable year, was $25,000 plus 50 percent of any remaining tax liability in excess of $25,000. The credit was not available to nonbusiness employers (e.g., employers of household employees). In addition, the credit was recaptured in the case of an employee who ceased to work for the original employer unless the employee voluntarily quit, became disabled, or was fired for misconduct before two years had passed.

The Tax Reduction Act of 1975 added the welfare recipient tax credit for the hiring of AFDC recipients who had received benefits for 90 days. This credit was essentially the same as the WIN credit except that it was available to both businesses and nonbusiness employers (with a $5,000 per year cap on eligible nonbusiness wages). A tax credit was allowable either under the WIN credit or welfare recipient tax credit but was not allowable under both with respect to the same wages paid to the same individual. The welfare recipient tax credit was to expire on July 1, 1976.

The Tax Reform Act of 1976 made several changes to both the WIN tax credit and the welfare recipient tax credit. Because the Congress was concerned that the WIN tax credit was not being used to the extent anticipated, revisions were made to encourage its greater use: (1) the credit was made available from the date of hiring if employment was not terminated without cause before the end of six months; (2) an additional exemption was added to the recapture rules so that no recapture would be required if an employee were laid off due to a substantial reduction in business; and (3) the limitation on the amount of the credit was increased from $25,000 to $50,000 plus one-half of tax liability in excess of $50,000. Three changes also were made to the welfare recipient tax credit: (1) its expiration date was extended to January 1, 1980; (2) a 12-month limit was imposed upon the period of time for which the credit could be claimed for any one employee; and (3) WIN agencies, as well as State and local welfare agencies, were permitted to certify eligibility for the credit.

2. New jobs tax credit

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978. This credit was equal to 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. (The FUTA wage base, for purposes of this credit, consisted of the first $4,200 of wages per employee.) The employer's deduction for wages was reduced by the amount of the credit. Thus, although the maximum gross credit with respect to each new employee was $2,100, the effective credit per employee ranged from $1,806 (for a taxpayer in the 14-percent tax bracket) to $630 (for a taxpayer in the 70-percent bracket).

There were four limitations on the total amount of credit which could be claimed: (1) the credit could not exceed 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid by the employer in the previous year; (2) the credit could not exceed 25 percent of the current year's FUTA wages; (3) the credit could not exceed $100,000 per year; and (4) the credit could not exceed the taxpayer's tax liability.

Special rules were provided for businesses not covered under FUTA, such as farms and railroads. Special rules also were provided for computation of the credit by groups of companies under common control, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions, and other changes in business from. Additional rules were provided for allocating the credit among members of a partnership and of a subchapter S corporation.

The 1977 Act also provided an additional, nonincremental credit equal to 10 percent of the first $4,200 of FUTA wages paid to handicapped individuals who received vocational rehabilitation. This credit was based on the first $4.200 of wages paid to a handicapped individual whose first FUTA wages from the employer were paid in 1977 or 1978. Only wages paid during the one-year period beginning when the individual first was paid FUTA wages by the employer were taken into account in computing the credit. The credit for handicapped workers could not exceed one-fifth of the regular 50-percent credit which would have been allowable without regard to the $100,000 limitation. However, this special 10-percent credit was not itself subject to any specific dollar limitation.

B. Revenue Act of 1978

The Revenue Act of 1978 substantially revised the provisions relating to tax incentives for employment. The new jobs tax credit was permitted to expire at the end of 1978 because Congress believed that the unemployment rate had declined to a level where it would be more appropriate to focus employment incentives on individuals who have high employment rates, even when the national unemployment rate is low, and on other groups with special employment needs. Thus, in place of the new jobs tax credit, Congress enacted a provision which was designed to provide an incentive for private employers to hire individuals in seven target groups, which were singled out on the basis of their low income or because their employment should be encouraged. The seven target groups consisted of (1) vocational rehabilitation referrals, (2) economically disadvantaged youths, (3) economically disadvantaged Vietnam-era veterans, (4) SSI receipients, (5) general assistance recipients, (6) cooperative education students, and (7) economically disadvantaged ex-convicts. (This provision is discussed more fully, below, under "Present law.")

Because Congress believed that employer utilization of the WIN and welfare recipient tax credits was far below what could have been achieved if the credit rate had been higher and the rules for claiming the credits had been simpler, the 1978 Act increased the credit rate and simplified the rules governing employer eligibility for the credits. In addition, the welfare recipient credit was made permanent. (These rules are discussed below, under "Present law.")

In addition to these substantive changes, the 1978 Act requires the Secretaries of Labor and Treasury to submit to the tax-writing committees a joint report concerning the effectiveness of the targeted jobs tax credit and the new jobs tax credit of prior law. This report is due no later than June 30, 1981.

II. PRESENT LAW

A. Targeted Jobs Tax Credit

(Code secs. 51, 52, and 53)

1. General rules

The targeted jobs credit, which applies to eligible wages paid before January 1, 1982, is available on an elective basis for hiring individuals from one or more of seven target groups. The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of the first $6,000 of qualified second-year wages paid to each individual. Qualified first-year wages are wages that are paid for services during the one-year period which begins with the day the individual begins working for the employer. However, in the case of a vocational rehabilitation referral, this period begins with the day the individual starts work for the employer that is on or after the beginning of the individual's rehabilitation plan. Qualified second-year wages are wages attributable to service rendered during the one-year period immediately following the close of the first one-year period.

Since no more than $6,000 of wages during either the first or second year of employment may be taken into account with respect to any individual, the maximum credit per individual is $3,000 in the first year of employment and $1,500 in the second year of employment. However, the deduction for wages is reduced by the amount of the credit (determined without regard to the tax liability limitation). Thus, for an employer who hires an eligible employee who earns $6,000 in his first year of employment, the credit results in an actual tax reduction that ranges from $900 (for an employer in the 70-percent bracket) to $2,580 (for an employer in the 14-percent bracket). However, because all wages are deductible for employees who are not members of target groups, after-tax costs of the first $6,000 of wages paid to such employees range from $1,800 (for an employer in the 70-percent bracket (to $5,160 (for an employer in the 14-percent bracket). Thus, the credit provides a 50-percent reduction in the after-tax costs of the first $6,000 of wages paid to target group employees in the first year of employment, regardless of the employer's tax bracket.

2. Target groups

The targeted jobs tax credit is available only with respect to the hiring of individuals who are members of one of seven target groups.

The statute contains certification provisions which relieve the employer of responsibility for proving to the Internal Revenue Service that an individual is a member of a target group. The Secretaries of Treasury and Labor are required jointly to designate a single employment agency in each locality to make this determination and to issue a certificate which, without further investigation on the part of the employer, is sufficient evidence that the individual is a member of such group. An exception to this procedure is made for cooperative education students, whose eligibility is certified by the qualified school participating in the program.

The seven target groups are described in detail in the following discussion:

(1) Vocational rehabilitation referrals

Vocational rehabilitation referrals are those individuals who have a physical or mental disability which constitutes a substantial handicap to employment and who have been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a state plan approved under the Rehabilitation Act of 1973, or under a rehabilitation plan for veterans carried out under chapter 31 of title 38, U.S. Code. Certification can be performed by the designated local employment agency, upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(2) Economically disadvantaged youths

Economically disadvantaged youths are individuals at least age 18 but not age 25 on the date they are hired by employers, and who are members of economically disadvantaged families (defined as families with income during the preceding 6 months, which on an annual basis would be less than 70 percent of the Bureau of Labor Statistics lower living standard as determined by the designated local employment agency).

(3) Economically disadvantaged Vietnam-era veterans

The third target group consists of Vietnam-era veterans certified by the designated local employment agency as under the age of 35 on the date they are hired by the employer and who are members of economically disadvantaged families. A Vietnam-era veteran is an individual who has served on active duty (other than for training) in the Armed Forces more than 180 days, or who has been discharged or released from active duty in the Armed Forces for a service-connected disability, but in either case the active duty must have taken place after August 4, 1964, and before May 8, 1975. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual is hired by the employer. This latter rule is intended to prevent employers that hire current members of the armed services (or those recently departed from service) from receiving the credit. The definition of an economically disadvantaged family and the procedures for certifying to the employer that an individual is a member of such a family are the same as those discussed above.

(4) SSI recipients

SSI recipients are those receiving either Supplemental Security Income under Title XVI of the Social Security Act, including State supplements described in section 1616 of that Act or section 212 of P.L. 93-66. To be an eligible employee, the individual must have received SSI payments during a month ending during the 60-day period which ends on the date the individual is hired by the employer. The designated local agency will issue the certification after a determination by the agency making the payments that these conditions have been fulfilled.

(5) *General assistance recipients*

General assistance recipients are individuals who receive general assistance for a period of not less than 30 days if this period ends within the 60-day period ending on the date the individual is hired by the employer. General assistance programs are State and local programs which provide individuals with money payments based on need. These programs are referred to by a wide variety of names, including home relief, poor relief, temporary relief, and direct relief. Examples of individuals who may receive money payments from general assistance include those ineligible for a Federal program, or waiting to be certified by such a program, unemployed individuals not eligible for unemployment insurance, and incapacitated or temporarily disabled individuals. Some general assistance programs provide needs to those individuals who find themselves in a one-time emergency situation; however, many of these families will not meet the "30-day requirement" described above. Because of the wide variety of such programs, the law provides that a recipient will be an eligible employee only after the program has been designated by the Secretary of the Treasury, after consultation with the Secretary of Health and Human Services, as a program which provides cash payments to needy individuals. Certification will be performed by the designated local agency.

(6) *Cooperative education students*

The sixth target group consists of youths who actively participate in qualified cooperative education programs, who have attained age 16 but who have not attained age 20, and who have not graduated from high school or vocational school. The definitions of a qualified cooperative education program and a qualified school are similar to those used in the Vocational Education Act of 1963. Thus, a qualified cooperative education program means a program of vocational education for individuals who, through written cooperative arrangements between a qualified school and one or more employers, receive instruction, including required academic instruction, by alternation of study in school with a job in any occupational field, but only if these two experiences are planned and supervised by the school and the employer so that each experience contributes to the student's education and employability.

For this purpose a qualified school is (1) a specialized high school used exclusively or principally for the provision of vocational education to individuals who are available for study in preparation for entering the labor market, (2) the department of a high school used exclusively or principally for providing vocational education to persons who are available for study in preparation for entering the labor market, or (3) a technical or vocational school used exclusively or principally for the provision of vocational education to persons who have completed or left high school and who are available for study in preparation for entering the labor market. In order for a nonpublic school to be a qualified school, it must be exempt from income tax under section 501(a) of the Code. In the case of individuals in this group, wages paid or incurred by the employer are taken into account only if the school certifies that the individual is enrolled in and actively pursuing the qualified cooperative education program, is age 16 through 19, and is not a vocational or high school graduate.

(7) *Economically disadvantaged former convict*

Any individual who is certified by the designated local employment agency as having at some time been convicted of a felony under State or Federal law and who is a member of an economically disadvantaged family is an eligible employee for purposes of the targeted jobs credit, if such individual is hired within five years of the later of release from prison or date of conviction. The definition of an economically disadvantaged famly and the procedures for certifying to the employer that an individual is a member of such a family are the same as those discussed above.

3. Limitations on amount of credit

Wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to the employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under Federally-funded programs, such as the Comprehensive Employment and Training Act (CETA). Moreover, the employer may not claim the targeted jobs credit for wages paid to an individual with respect to whom a WIN credit is claimed.

In order to prevent the hiring of targeted employees from displacing a substantial number of non-targeted employees, qualified first-wages for all targeted employees may not exceed 30 percent of FUTA wages for all employees during the calendar year ending in the current tax year.

Finally, in order to prevent taxpayers from escaping all tax liability by reason of the credit, the credit may not exceed 90 percent of the employer's tax liability after being reduced by all other nonrefundable credits, except the residential energy credit (sec. 44C), the credit for producing fuel from a conventional source (sec. 44D), and the alcohol fuel credit (sec. 44E). Excess credits may be carried back three years and carried forward seven years.

4. Special rules

For purposes of determining the years of employment of any employee, wages for any employee up to $6,000, and the 30-percent FUTA cap, all employees of all corporations that are members of a controlled group of corporations are treated as if they are employees of the same corporation. Under the controlled group rules, the amount of credit allowed to the group is generally the same which would be allowed if the group were a single company. Comparable rules are provided in the case of partnerships, proprietorships, and other trades or businesses (whether or not incorporated) that are under common control. Thus, all employees of such organizations generally are treated as if they are employed by a single person. The amount of targeted jobs credit available to each member of a controlled group is each member's proportionate share of the wages giving rise to the credit.

The targeted jobs tax credit may be used as an offset against the alternative minimum tax except to the extent that the minimum tax is attributable to net capial gains and adjusted itemized deductions.

B. WIN Tax Credit

(Code secs. 50A and 50B)

1. General rules

In the case of trade or business employment, taxpayers are allowed a WIN tax credit equal to 50 percent of qualified first-year wages and 25 percent of qualified second-year wages paid to WIN registrants and AFDC recipients. For employment other than in a trade or business, the credit is 35 percent of qualified first-year wages.

No more than $6,000 of wages during either the first or second year may be taken into account with respect to any individual. Thus, the maximum credit per individual employed in a trade or business is $3,000 in the first year of employment and $1,500 in the second year of employment. Since the employer's deduction for wages is reduced by the amount of the credit, an employer who pays an eligible employee $6,000 in his first year of trade or business employment receives an actual reduction in taxes ranging from $900 (for an employer in the 70-percent bracket) to $2,580 (for an employer in the 14-percent bracket). However, because all wages are deductible for non-eligible employees, after-tax costs of the first $6,000 of wages paid to such employees range from $1,800 (for an employer in the 70-percent bracket) to $5,160 (for an employer in the 14-percent bracket). Thus, the credit provides a 50-percent reduction in after-tax costs of the first $6,000 of wages paid to eligible employees in the first year of employment, regardless of the employer's tax bracket.

2. Eligible employees

An eligible employee is one who either is a member of an AFDC family that has been receiving AFDC for at least 90 continuous days preceding the date of hiring or is placed in employment under the WIN program. Either of these requirements must be certified to by the Secretary of Labor or by the appropriate state or local agency. In addition, for the credit to be available, the employee must be employed by the taxpayer for more than 30 consecutive days on a substantially WIN program. Either of these requirements must be certified by the full-time basis, or, in the case of an employee whose employment is related to providing child day care services, on a full-time or part-time basis.

No credit is available in the case of: (1) expenses reimbursed, for example, by a grant; (2) employees who displace other employees from employment; (3) migrant workers; or (4) employees who are close relatives, dependents, or major stockholders of the employer.

3. Limitations on amount of credit

The WIN-welfare recipient tax credit may not exceed 100 percent of tax liability. Unused credits may be carried back three years and carried forward seven years.

In the case of non-trade or business wages, the maximum amount of creditable wages is $12,000. In effect, this permits a taxpayer to claim the credit for up to two full-time nonbusiness employees.

Finally, the credit for dependent care expenses (Code sec. 44A) may not be claimed with respect to any wages for which the taxpayer is allowed a WIN-welfare recipient credit.

4. Special rules

The WIN-welfare recipient credit contains rules similar to those applicable in the case of the targeted jobs credit for controlled groups. Thus, the amount of credit allowable to each member of a controlled group is the member's share of wages giving rise to the credit.

The WIN credit may be used as an offset against the alternative minimum tax, except to the extent that the alternative minimum tax is attributable to net capital gains and adjusted itemized deductions, to the extent the credit is attributable to the active conduct of a trade or business by the taxpayer claiming the credit.

There is a special 100-percent credit with respect to unreimbursed wages paid to workers whose wages are reimbursed in whole or in part by funds made available under section 2007 (grants to hire welfare recipients as child care workers) of the Social Security Act. If the taxpayer elects to compute the credit using this rate, the credit with respect to any employee is limited to the least of: (1) $6,000 minus the reimbursement with respect to this employee under section 2007, (2) $3,000 (for the first year of employment) or $1,500 (for the second year of employment), or (3) 50 percent (for the first year
x of employment) or 25 percent (for the second year of employment) of the sum of unreimbursed wages and the reimbursement under section 2007.

III. BACKGROUND INFORMATION ON USE OF EMPLOYMENT TAX CREDITS

A. Data on Certifications

1. Targeted jobs tax credit

Table 1 presents figures on the number of certifications issued under the targeted jobs tax credit. Certifications are issued at an employer's request, to support a claim for the tax credit, after a member of a target group has been hired.

Cooperative education youth are the group for which the largest number of certifications has been issued. As of December 1980, 47.2 percent of all certifications issued were for members of this group. Of the total certifications issued in 1979, approximately the same percentage (50.3) of certifications also were for this group. Thus, apart from seasonal patterns, presumably related to the school year, cooperative education students appear to steadily receive about half of the certifications.

Economically disadvantaged youth have received the second largest number of certifications. As of December 1980, these youths had received 36.7 percent of all certifications. The absolute number of certifications going to this group has been increasing steadily over the period, rising from a monthly average of 4,086 in 1979 to 11,945 in the last three months of 1980.

The number of certificates issued for members of the other five targeted groups is much smaller than for either cooperative education youth or economically disadvantaged youth. Figures for economically disadvantaged Vietnam-era veterans and ex-convicts and for handicapped individuals have each averaged approximately 1,100 per month and have shown no clear trend over the period covered by these figures. The number of general assistance and SSI recipients participating in the program has been even smaller; for the former group, however, the number of certificates appears to be increasing slowly.

TABLE 1.—NUMBER OF CERTIFICATIONS ISSUED UNDER TARGETED JOBS TAX CREDIT, BY TARGET GROUP

Period	Economically Disadvantaged			Handicapped	Cooperative education youth	General assistance recipients	SSI recipients	Total
	Youth	Vietnam veterans	Ex-convicts					
1979								
March to December	36, 774	4, 330	4, 768	6, 119	54, 764	1, 585	390	108, 730
1980								
January	6, 828	979	972	1, 253	21, 875	334	91	32, 332
February	7, 153	984	1, 286	1, 359	18, 506	375	82	29, 745
March	8, 758	1, 146	1, 255	1, 378	11, 634	471	84	24, 726
April	8, 569	1, 183	1, 316	1, 480	8, 059	498	64	21, 169
May	7, 804	895	1, 104	1, 239	6, 906	509	55	18, 512
June	8, 212	986	1, 078	1, 196	5, 648	551	49	17, 720
July	8, 935	1, 031	1, 106	1, 036	4, 288	493	47	16, 936
August	9, 278	995	986	1, 122	1, 753	552	42	14, 728
September	11, 372	1, 206	1, 174	1, 116	5, 484	750	43	21, 145
October to December	35, 834	3, 339	3, 484	3, 649	53, 301	1, 981	201	101, 789
Total	149, 517	17, 074	18, 529	20, 947	192, 218	8, 099	1, 148	407, 532

Source: U.S. Employment Service.

2. WIN tax credit

Table 2 presents recent figures on use of the WIN tax credit. The first column shows the number of certificates issued to employers for eligible employees and thus is roughly comparable to the data in Table 1. The number of certificates issued has grown sharply since 1978.

The second and third columns of table 2 show the number of tax returns on which the WIN credit was claimed. There is no apparent explanation for the drop between 1977 and 1978 in the number of individuals claiming the credit. However, for both corporations and individuals, there was a sharp jump in this figure between 1978 and 1979, which is consistent with the jump in the figures in the first column.

The number of both participating employees and participating employers grew sharply after 1978; this may be attributable to the modifications made to the credit by the Revenue Act of 1978.

TABLE 2.—DATA ON RECENT USE OF WIN TAX CREDIT

Year	Tax credits authorized [1]	Number of tax returns claiming credit	
		Corporations [2]	Individuals
1977	35, 266	5, 038	15, 785
1978	36, 085	5, 308	4, 817
1979	42, 713	6, 538	7, 524
1980	52, 625	(3)	(3)

[1] Fiscal years.

[2] Taxable years ending between Oct. 1 of the specified year and Sept. 30 of the following year.

[3] Not available.

Source: U.S. Department of Labor; Internal Revenue Service.

B. Evaluation Reports

1. Ohio State University study[1]

Overview

A series of reports evaluating the implementation of the targeted jobs credit has been written for the U.S. Department of Labor by researchers at Ohio State University. These reports were based primarily on field interviews with administrators and employers in 25 sites around the United States; the latest interviews were conducted in October 1980.

The basic findings of the report are that the hiring patterns of most employers have not responded to incentives provided by the targeted jobs credit, although some employers say that they have shifted hiring to the target groups. In addition, many of the employees of the local agencies administering the credit are skeptical of it and reluctant to use it as a placement tool. A majority of the certifications issued to employers generally have been retroactive, that is, the determination of whether an employee is eligible has been made by the certifying agency (the local Employment Service) after the hiring decision has been made. Some Employment Service offices were found to be more reluctant than others to issue retroactive certifications, but those which were reluctant had difficulty in meeting their numerical goals. Toward the end of the period covered by the report, there appears to have been a decline in the percentage of certifications which were retroactive.

Attitudes of certifying agencies

The report found considerable variety across areas in the aggressiveness with which local Employment Service offices have marketed the credit. In some areas, many of the local agency employees believe that publicity and marketing at the national level has been inadequate, as have the financial resources and organizational incentives for taking the credit seriously. These attitudes have affected the enthusiasm with which these employees have pursued their own efforts to use the credit as a placement tool. However, the level of marketing apparently does not appear to have a great effect on the local offices' ability to achieve certification goals or on the proportion of certifications which are retroactive.

The various agencies involved in identifying target group members have widely varying attitudes about the desirability of the tax credit programs. The report found that employees of CETA prime sponsors were generally negative, since they viewed the credit as antithetical to what they saw as their basic mission—to train individuals for unsubsidized placements—rather than to compensate employers for employees' lack of productivity. Employment Service employees were found to be less negative, but they feel, in many cases, that the credit increases their workloads without positive results and is a windfall for employers who were already hiring substantial number of employees from the target groups. On the other hand, vocational rehabilitation agencies and agencies placing ex-offenders believe that the credit is a useful placement tool. Employees of cooperative education agencies believe that the credit is useful to reward employers for their participation in the cooperative programs, but they do not believe that the credit is needed to obtain placements for their students.

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[1] Mershon Center CETA Study, Ohio State University, *The Implementation of the Targeted Jobs Tax Credit*, Report Nos. 1 (July 1980) and 2 (January 1981).

Attitudes of employers

Some employers believe that the credit has changed their hiring practices, although many believe that the credit is not large enough to compensate them for the costs of hiring members of the target groups and of participating in the credit. These perceived costs include lower productivity of target group members, increased costs of screening potential employees from target groups, fear of employment discrimination charges, increased probability of an IRS audit, and general reluctance to participate in government programs. Some employers also have found that the system for administering the credit is too uncoordinated, because of the large number of agencies involved.

Study recommendations

The authors of the report reach tentative conclusions about changes in the targeted jobs credit program which they believe may improve its effectiveness. These include:

1. Eliminating eligibility for students in cooperative education programs in order to focus the credit on people who clearly need it to obtain employment.
2. Increasing the amount of the credit.
3. Eliminating the option of having employees certified retroactively.
4. Providing additional funds to implement the program so that staff can be assigned to focus on marketing and administering the credit.
5. Centralizing implementation of the credit in a single agency, or providing that one agency has the authority required to coordinate the efforts of other agencies.
6. Establishing uniform questionnaires and procedures for determining eligibility of participants in the various target groups.
7. Reducing requirements for documenting participants' eligibility for the credit.

In addition, some of the local agency employees believe that the WIN credit should be merged with the targeted jobs credit to reduce confusion which arises from the existence of two separate credits with similar goals.

2. Northeast-Midwest Institute report[2]

The Northeast-Midwest Institute issued a report on the targeted jobs tax credit in September, 1980. The report reviews the implementation of the credit and makes several recommendations for both legislative and administrative changes.

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[2] Northeast-Midwest Institute, *Putting the Targeted Jobs Credit Back to Work*, September, 1980.

The report criticizes the initial decision of the Department of Labor to assign responsibility to the CETA "prime sponsors" for identifying the three economically disadvantaged groups. Some CETA agencies were more accustomed to dealing with individuals who were not ready for a job than with those who were looking for immediate placement. Employment Service offices should have been given more responsibility, according to the report; this would have improved the implementation of the credit in its first months. In January, 1980, the Employment Service was given the authority to identify individuals in all target groups except cooperative education students.

Cooperative education agencies are found to be relatively enthusiastic about the program, but they admit that employers receiving the credit are those who have hired cooperative education students in the past and would have continued to do so without the credit.

The report also claims that Employment Service offices have not made a coordinated effort to refer target group members to employers. Further, retroactive certification is criticized as reducing the productivity of the employees administering the program.

The authors of the report make several recommendations for changing the administration of the credit, including more guidance from the national office of the Employment Service, greater publicity, funds earmarked specifically for administrative costs associated with the credit, and giving the Employment Service more authority to coordinate the program with other agencies. Several legislative recommendations also are made, including dropping cooperative education students from the program or limiting eligibility only to those who are economically disadvantaged, making the credit refundable, allowing employers both a credit and a full deduction for wages paid to eligible employees, allowing the credit against payroll taxes, disallowing retroactive certification, and targeting of distressed areas.

3. Wisconsin Health and Social Services Department report [3]

The Wisconsin Department of Health and Social Services has written a report based on interviews with administrators of the WIN and targeted jobs credits and with employers. The authors find that the credits are underutilized, relative to the eligible population, and that lack of knowledge on the part of both employers and administering agencies was the major factor accounting for their low utilization. Some employers believed that participation in the credit would entail excessive paperwork, would increase the risk of a tax audit, and would conflict with affirmative action principles. In addition, some of the agency employees found a conflict between the idea of subsidized employment and what they viewed as their primary goal—improving human capital. As a result, there was considerable variation in the degree to which the credits were part of the agency's standard placement efforts. No specific problems were found with the design of the subsidy. With respect to the targeted jobs credit, employers found confusing the diffusion of administrative responsibility among different agencies, although lack of Federal resources for administration may account for some of the perceived administrative problems.

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[3] *A Report of the Wage Bill Subsidies Research Project, Phase I.* Office of Client Employment Programs, Division of Policy and Budget, Wisconsin Department of Health and Social Services, November 1980.

Prepared Statement of Hon. Ron L. Wyden, a Representative in Congress From the State of Oregon

THE STATE OF OREGON'S SUCCESS WITH INDUSTRIAL DEVELOPMENT REVENUE BONDS AS AN ALTERNATIVE SMALL BUSINESS AND JOB DEVELOPMENT TOOL

Mr. Chairman, I appreciate the opportunity to testify before your subcommittee this morning in support of continuing small issue Industrial Development Revenue Bonds. We must continue this alternative method of financing for medium size and small businesses. The State of Oregon has been active in this area for 13 years obligating $113 million in IDRBs.

These successful IDRB loans come at a time when my state is projecting an unemployment rate of 12 percent by January of 1982. Clearly, Mr. Chairman IDRBs can work for small business and employment development.

Over these 13 years, the small issue industrial development revenue bond program has created an estimated 3,200 new jobs in the state and attracted firms engaged in developing new technology helping my state diversify our timber and housing-based economy.

Obviously, Mr. Chairman high interest rates figure into the attractiveness of IDRBs. State officials say that the current prime plus two rate given to small businessmen make IDRB financing a viable alternative to traditional bank loans. In 1980 alone, the State of Oregon issued $66 million IDRBs attracting new money into the state.

The State of Oregon eliminated using IDRBs for commercial and retail developments. State economic development officials note that IDRBs create a multiplier affect in the development of secondary economic activity around light manufacturing and other innovative small high technology firms which are the primary recipients of IDRB financing. These secondary investments are usually commercial and retail developments financed through traditional sources.

State official also feel this program has a self-levelling effect in that the major Oregon banks participate in the program within prudent investment levels and fluctuations in interest rates and other competitive traditional financing plans and programs balance out the issuance of IDRBs.

Brokerage firms are enthusiastic about the future of IDRBs as a source of equity capital. Some have suggested that bond lending programs be increased to $15 to $20 million from the current $10 million limitation. I recognize that many small business people may object to increasing loan limits feeling that small entities could not use these funds. However, I feel there will be sufficient capital for small business investments in the $500,000 to $5 million loan range.

I recently participated in a ribbon-cutting ceremony at a firm in my district that received an IDRB loan. The firm, O.K. Delivery was able to keep its service competitive and increase employment. The state also attracted a new generation, energy efficient furnace manufacturing firm with IDRBs. The firm, Clean Air Products will create 7 to 10 new jobs over the next three years.

Those who would like to see IDRBs eliminated point to commercial and retail development use as the reason this program should be curtailed or eliminated. They also point out that IDRBs result in a reduction in federal and state revenues due to these bonds tax-exempt status. Some even proclaim that IDRBs subsidize business development. I take issue with these criticisms and short-sighted vision of IDRBs because I am convinced that IDRBs increase the tax base by attracting new businesses and creating new jobs.

Some small business people have expressed doubts about the program because of the closing costs associated with packaging IDRBs. Most bonding and surety brokers have assured me that the complaints about legal and closing fees are overrated. Most of these expenses can be converted into the loan at interest rate levels many points below conventional loans.

I am a co-sponsor of H.R. 4507 introduced by Rep. Thomas Downey which will delay implementation of an I.R.S. ruling to eliminate tax exemption for multiple lot small issue revenue bonds less than $1 million. This action by I.R.S. will effectively curtail small business borrowing through IDRBs. I urge members of this subcommittee to support this legislation to keep this equity capital tool for small businesses.

Once again, I want to express my appreciation for being allowed to address the subcommittee on this issue. I feel that the continued prudent issuance of these bonds can be made to attract and provide equity capital to innovative new small firms which will lead our country out of our current economic condition and provide new employment opportunities.

SUBMITTED REMARKS OF STATE SENATOR WALTER J. FLOSS (R.-C., NEW YORK STATE)

Ladies and Gentlemen: I appreciate your invitation to address this subcommittee, and the grace which your Chairman has extended in permitting me to submit written remarks.

I am Walter Floss. I represent, in the New York State Senate, the Northern portion of Erie County as well as Genesee County and the Town of Sweden in Monroe County. In fact, my district borders the Chairman's Congressional district. We are neighbors, in a manner of speaking.

New York State, even more so than the rest of the country, has had serious difficulty during the decade-long recesssion we have all experienced. Inflation, slow economic growth, unemployment and high interest rates have had a particular impact on a State, and a region, which is saddled with large and old industries whose physical capacities are simply inadequate for the demands of the modern economy. The command issued to all the species—"change or die"—has a real urgency about it in New York State.

In light of this, we in New York have recognized, as I suspect you have, that the best way to generate change in a stagnating economy is to promote the growth of small business. As the now-famous Birch study indicates, small businesses are both our best source of new jobs in the private sector, and more flexible than large businesses to meet and take advantage of new trends in our economy.

But what are the particular problems which small businesses face? In my term as Chairman of the State Senate Small Business Subcommittee, I found that—along with the problems which small businesses face in attempting to cope with massive government regulations, small business' most pressing problem is their inability to raise capital. Although not all small businesses are new businesses, most new businesses are small businesses—and without a track record, a new, small business has real difficulty obtaining a conventional loan. Even for established small businesses, it is extremely expensive to borrow money on the conventional market—since the amount requested seldom generates enough dollar return at the prime rate to interest most private lending institutions.

Thus, during the late sixties and the seventies, a number of financing devices developed which promised to spur economic development in those areas of the nation which most needed it. Foremost among these devides were Industrial Development Agencies (IDAs) and Industrial Revenue Bonds (IRBs)—the subject matter of your subcommittee hearing.

When I founded the first IDA in New York State—the Erie County Industrial Development Agency—I did so because I intended to attract those industries which would create new jobs in Western New York. Back then, when interest rates were lower, our primary concern was finding locations for those industries and helping them to obtain the tax relief from the host municipality which they needed to absorb the cost of relocating. Now, as I'm sure the ECIDA's present executive director, William Donoghue, has told you, procuring start-up capital through IRBs is a major function of the ECIDA.

Ladies and Gentlemen, there is no question but that businesses must find some relief from the temporarily astronomical interest rates which have resulted from the economic dislocations we are experiencing. Otherwise, there will be no economic growth . . . and New York will become a perpetual supplicant at the federal trough—something I'm sure neither this subcommittee nor Congress wants.

It is my understanding that the subcommittee is considering an IRS ruling which would deny tax-exempt status to IRBs which are issued in behalf of an aggregate of projects. IRBs issued in behalf of only one project would retain the tax-exempt status which Congress created for them.

Ladies and Gentlemen, the only way small businesses are ever going to benefit from IRBs is through the issuance of aggregate bonds. Small businesses borrow money for small projects—small when considered on the scale of the nation's economy, but very large indeed to the businessman trying to get a loan. One hundred thousand dollars, for example, may seem like a lot of money to you or me, but it is simply not big enough to interest a bond buyer. By the time the bond purchaser gets through paying bond counsel and the other administrative costs of the bond, the interest revenues which the bond would generate are already consumed in costs. In fact, surveys which I have done and other studies which I have read indicate that $750,000 is the minimum practical size of a "go it alone project". Less than that, and cost of bonding exceeds the benefits.

Having recognized that small businesses in the aggregate are the most prolific producers of new jobs, we should permit small businesses, in the aggregate, to obtain the capital necessary to produce those jobs.

Every hearing I have held as Senate Small Business Subcommittee Chairman has led me to believe that IRBs, or IDBs as they are sometimes called, are absolutely vital to small business investment, expansion and development. Here, for example, is what a representative of the Genesee County Industrial Development Agency said:

"IDB financing is one of the most vital tools available for industrial acquisition, expansion, construction, and rehabilitation of machinery and equipment. Moreover, in communities the size of Batavia—a city of about 30,000 in Genesee County—it is an extremely valuable tool desperately needed in the creation of jobs, payrolls and taxes when your present unemployment rate is 12.6 percent and could go even higher. A tool of this nature can only enhance the commercial and industrial growth of our area."

Likewise, the Erie County Industrial Development Agency indicates a heavy reliance on IRBs for economic development:

"It is interesting to note that 28 of 37 ECIDA small issue tax-exempt bonds closed in 1979–80 were for firms and industries targeted for expansion or retention . . . from 1971 to 1978 the Agency issued 36 IRBs for a total of $39 million. In 1979 and 1980, 38 issues for $89 million were completed. That represents more than a 225 percent increase in volume of sales during a 2-year period . . .

"Our experience leads us to conclude that tax-exempt small issues serve as a powerful capital formation vehicle which can stimulate net new investment and jobs which might otherwise not occur. They have a positive impact on the amount of investment, the timing of investment, and on the basic investment decision and its location . . . Moreover, these impacts are most effective as they relate to investment decisions by new and small business firms."

More localized economic development concerns also rely on IRBs. They use them only when necessary. Under the procedures of the Town of Amherst Industrial Development Agency, and IRB can be given only when "But for the availability of IDB financing for such project in such area the project would not be economically feasible." Prior to this year, Amherst's IDA has issued 13 bonds for over $14 million in new industrial parks which have resulted in hundreds of new jobs.

The Town of Tonawanda Development Corporation testified: "Utilization of the Industrial Revenue Bond authority of the Agency has enabled the Town to retain one manufacturing firm which would otherwise have left the State were the Authority not in place, and another which would have closed down with a loss of 150 jobs. In addition, revenue bond financing has allowed four other manufacturing firms to expand their plants and facilities, and two steel service centers to relocate in the Town—one into a rehabilitated, formerly deteriorated and vacant structure, the other into a new building in a recently opened industrial park. As a result of using revenue bond financing 480 jobs have either been created or retained."

You have probably discovered for yourself that today, successful economic development projects depend on IRB financing. If the project is for less than $750,000, an aggregate bond issue is a necessity. By removing the tax-exempt status of aggregate bonds, the IRS closes the door on most small businesses.

Now, perhaps the federal government is trying to reduce demand on the credit market by reducing the number of government-assisted loans. If that's the case, then perhaps Congress should repeal the tax-exempt status of all IRBs—whether they're for individual projects helping big businesses or for aggregate projects helping small businesses. I don't think that such a move would be good policy, but it would at least be fair. It is unfair for our tax policy on IRBs to discriminate against small businesses. In light of the fact that small businesses are our major producers of new jobs, such a policy is not only unfair—it doesn't make any sense.

Last year, Congress recognized that small businesses don't have the same capacity to cope with government regulations that large businesses have. As a result, you enacted the Regulatory Flexibility Act. We must now recognize that small businesses don't have the same capacity to raise revenues through single-issue bonds that large businesses have. Isn't the remedy to that disparity similar? Even as regulatory flexibility provides the means for small businesses to cope with government regulation, so to does aggregate bonding provide the means for small businesses to cope with the current credit market.

Without a tax-exempt status for aggregate IRBs, small businesses aren't going to be able to make use of IRBs. Unless small businesses are able to make use of IRBs, small businesses aren't going to be able to expand. Unless small businesses expand, New York and the other older industrial states aren't going to be able to put their economic houses in order. It's as simple as that.

Now, it may be the case that there are abuses of IRBs. If so, those abuses should be eliminated so that the demand on the credit market is reduced. But as you look at the IRB problem, I think that you should do so with the fundamental principles which got government into the economic development business in the first place in mind. What sort of economic development produces—creates—new jobs? It is this sort of economic development which should receive the benefit of tax-exempt IRBs.

There is a very real difference between economic development for the retail sector and the non-retail sector. Try as you might, you can't create retail jobs. The decision to build a retail outlet is based upon one thing, and one thing only—market. If you market snowmobiles, ladies and gentlemen, you are not going to move to Florida—even if you can get a massive building loan at low interest and never have to pay a dime in taxes on your snowmobile revenues. By the same token, if your proposed market area is already saturated with the product you hope to sell, you're never going to open a business—and create jobs.

Of course, you could move into that saturated market and take jobs from existing businesses. But that doesn't do the community much good, does it?

I'd like to quote from a letter which the Buffalo Evening News published on October 14 of this year. It's from a real estate man who urgently wants a mall constructed in the Town of Hamburg, Erie County. Now I should tell you that there are plenty of malls in Western New York and plenty of malls in Erie County. Consumers are not obliged to stand in line outside of a General Store in order to buy products. But this writer thinks we need another mall, and here's why:

"There will be 2,000 permanent jobs after the mall is completed," the writer enthuses. "People living in Hamburg now travel to Amherst or West Seneca to do their mall shopping. A mall in Hamburg will keep Hamburg dollars in Hamburg."

Well, that's precisely the point, isn't it? If the Hamburg mall gets off the ground and is eventually a success, it may very well employ two thousand people. But there won't be two thousand new jobs. The Hamburg mall's success will be because people who used to travel to West Seneca and Amherst would now shop in Hamburg. Thus, the revenue the Hamburg mall obtained would be the same revenue which the Amherst and West Seneca malls lost. The drop in activity in the other malls would cause closing and layoffs * * * and the two thousand "new" jobs in Hamburg would be counterbalanced by two thousand lost job elsewhere.

Now, I don't know if there's IDA money in this proposed Hamburg mall or not. If there isn't I'm sure you join me in wishing the people involved in the Hamburg project all the best. If they can provide better service for less money, more power to them—that's the American way. But if there is IDA money involved, then something strikes me as terribly wrong. IDA money to support a retail venture doesn't create new jobs. It just gives new businesses a competitive advantage as against older businesses.

The story is different in the other parts of our economy. Market considerations, of course, continue to have a bearing on non-retail decision-making. Nobody manufactures buggy-whips any more. But non-retail decision-makers are not the market captives retailers are. Outside of the retail field, decision-makers can take into account such questions as whether there is a market outside of the country for something which can be produced in the country and whether there will be a market in the future for something which can be produced right now.

One of the things which is taken into account by non-retailers before they establish themselves in a community or expand is how much the proposal will cost. For that reason, many communities rightly provide tax abatements for new and expanding industries. For the same reason, IDAs should continue to be able to provide new and expanding industries with assistance in meeting high capital costs.

I think that it is the business of every IDA to provide the incentive, and, to the extent practicable, the means for new non-retailers to enter the entrepreneurial community and for existing non-retailers to expand their capacities. This creates jobs. I do not think that it is the business of IDAs to subsidize one retailer's competition with another's for a limited dollar market.

Consistent with the philosophical framework of Federalism which this Congress adopted with the 1981-82 budget, I am not advocating that the workings of the federal law be used to prevent IDAs from issuing IRBs in behalf of retailers. I am suggesting that we rethink the federal tax exemption which Congress provides for IRBs which finance retail projects.

My proposal, in short, is that IRBs be tax-exempt when they finance small non-retail projects—projects which create jobs, as opposed to projects which simply take jobs away from competitors—regardless of whether the bond issuance is for one such project or for many. By the same token, IRBs should be subject to tax when they finance retail projects—regardless of the number of projects backed by the IRB. Where IRBs finance a mix of non-retail and retail projects, they should be subject to tax in proportion to the portion of the revenues used to finance retail projects.

Although any cutback in the IRB program will limit access into the business community, it is my view that this sort of job-creation oriented limitation of the IRB tax exemption is infinitely preferable to a wholescale removal of the exemption for aggregated bonds. Particularly in light of the limitations on lending which the Small Business Administration is adopting, aggregate IRBs represent the only chance for many small businesses.

Mr. Chairman, and members of this subcommittee, I thank you for this opportunity. I believe that this subcommittee, through its efforts and those made by the full Small Business Committee, its counterpart in the Senate and by President Reagan, will help to bring about the original vision of de Tocqueville and Alexander Hamilton—of a nation where every man and woman with enough determination and skill to make his own business work will have an opportunity to do so.

NEW YORK STATE ECONOMIC DEVELOPMENT COUNCIL

RESOLUTION OF EXECUTIVE COMMITTEE OF NYS EDC ADOPTED AT ROCHESTER, N.Y. ON OCTOBER 7, 1981

Whereas since the New York State Economic Development Council regards Industrial Development Bonds as an important economic and community development tool to stimulate capital investment and employment at a time when federal development assistance is being sharply reduced or eliminated, this financing mechanism must remain available to industrial development agencies in New York State, to the New York State Job Development Authority and to other public benefit corporations as a development incentive for private investment; and

Whereas we also recognize that legitimate concerns have been raised regarding abuse of small issue industrial development bonds, particularly those issued for commercial purposes: Therefore be it

Resolved that the New York State Economic Development Council, Recommends the following changes in Federal Legislation in response to that criticism:

1. Target commercial IDB's to distressed areas by providing broad federal guidelines within which States have the flexibility to determine the targeted areas based on state and local economic objectives.
2. Exempt from these restrictions special economic activities which are of particular importance to a specific state's economy and which encompass less than five percent (5 percent) of the state's economic base.
3. Exempt all production activities from research-processing to warehouse-distribution from targeting limitation.
4. Establish federal monitoring and annual reporting requirements by states for all small issue IDB's issued.

PREPARED STATEMENT OF ROGER J. VAUGHAN, DEPUTY DIRECTOR, OFFICE OF DEVELOPMENT PLANNING, NEW YORK STATE

INDUSTRIAL REVENUE BONDS

Mr. Chairman, members of the Subcommittee, it is a pleasure to appear at these important hearings on behalf of Governor Hugh L. Carey. Governor Carey heads the Economic Development Committee of the Coalition of Northeastern Governors (CONEG). The Coalition regards IBDs as a critical element in their program to rebuild the Northeastern economy and views attempts to abolish or undermine the use of revenue bonds as a serious blow to those efforts. At its annual meeting in August 1981, CONEG adopted a resolution supporting the limitation of IBDs for commercial projects but strongly endorsed the retention of the program.

Following the Treasury ruling 81-216 issued in August, Governors Thornburgh and Garrahy, on behalf of CONEG, wrote directly to President Reagan requesting that the ruling be withdrawn. I have attached copies to this testimony.

We are aware of the need to control public spending and to plug tax loopholes, but we do not think that the capricious action by the IRS is an effective way to achieve these goals. Not only will the ruling unfairly and needlessly penalize small businesses—precisely those companies that are denied alternative sources of long term financing—but it also undermines the "new federalism" so recently espoused by the Administration by removing a powerful policy instrument from state and local governments. Indeed, it even poses a threat to the constitutional right of state and local governments to issue tax exempt securities for public purposes.

Treasury Ruling 81-216

The abuse of Industrial Revenue Bonds to finance retail operations, fast food franchises, and even adult book stores has been well-documented in newspaper reports and in a careful report by the Congressional Budget Office. New York and other Northeastern states has recognized that, too often, the right to issue tax exempt bonds has been extended far beyond the original public intent, and has been used to finance projects that were capable of being financed through conventional means. We have called for limitation of IDBs, non-industrial IDBs (see below).

However, the Treasury ruling is completely inappropriate way of limiting the use of IDBs. It will exclude small and new businesses, regardless of their contribution to the local community and their need for finance. We applaud the efforts by Congressman Tom Downey to introduce legislation (H.R. 4507) to delay the implementation of this "cruel and unusual" ruling and urge the House, and the Senate, (where comparable legislation has been proposed by Senators Weicker and D'Amato (S. 1635) to reverse this ruling.

Pooling—which is prevented by the Treasury ruling—allows the fixed costs of issuing bonds to be spread over several issues, which reduces the costs to small firms. There will be no impact on reducing issues for commercial projects—the majority of which are private placements—or for large firms. The ruling will eliminate only small firms, which are exactly those companies which could benefit most from IRBs and whose financing will benefit the local community by providing new jobs.

The ruling also penalizes the efforts by states to help expand this economic base. The Pennsylvania Industrial Development Authority, the Economic Development Authority in New Jersey, the Massachusetts Industrial Finance Authority, the Umbrella Bond program in Connecticut, and the Job Development Authority in New York have all used the tax exempt to help generate jobs. The New York State Job Development Authority, in its 20 years of existence, has made nearly $200 million of loans to 1,200 companies that employ 90,000 New Yorkers. Many of these companies are located in distressed neighborhoods. Their survival—made possible by JDA's assistance—has brought renewed hope and economic opportunity to those by-passed by the economic mainstream. This fall the people of New York will vote on a referendum to extend JDA's bonding capacity from $150 million to $300 million. Governor Carey regards this as a top priority in the State's continuing program for economic recovery. The Treasury ruling will prevent JDA from assisting small and new businesses.

The intent of the IDB programs operated by states and localities is two-fold. First, to assist small and new businesses in acquiring capital on terms comparable to large businesses. Second, to assist companies in distressed areas have access to capital when it is not available from conventional lenders. We have met these goals effectively and prudently. JDA has a loss record comparable to many banks and has never required any direct state support. Few federal development finance programs can boast such a record.

The Economic Climate

The attack on IDBs could not come at a less appropriate time. Real interest rate—the difference between the rate of inflation and the rate charged by banks—has reached the highest level in fifty years. Small businesses, with little access to equity capital, are facing crippling interest costs.

Indeed, not only do small firms face problems in raising capital but states and localities are finding it increasingly difficult to borrow funds. The new "All-Savers" certificates will tighten the tax-exempt market still further. However, abolishing IDBs would provide no relief according to most studies. While about $8 billion of IDRs will probably be issued during the next 12 months, estimates of the volume of "All-Savers" certificates run as high as $150 billion. If the IRS wishes to close costly and ineffective loopholes, IRDs are the last place they should look.

Limiting IDRs

There are effective and equitable ways to reduce the volume of IDRs without jeopardizing their use as an economic development strategy. We support limiting commercial projects eligible for IDB financing to distressed areas. Outside targeted areas, commercial projects do not merit the interest subsidy—a fast food franchise will be built if there is a market for it with or without a subsidy. Congress should take action to eliminate the abuses whose coverage by the press has led to the present hostile climate to industrial revenue bonds.

However, we would not suggest Congressional legislation that would place the responsibility for designation of distressed areas on the Federal Government. State governments know better than federal bureaucrats where assistance is needed and must have the power to identify target areas.

Members of the Administration have indicated that they wish to abolish all IDBs, pollution control bonds and hospital bonds. This would be an irresponsible and harmful step. Targeting can reduce program costs, just as expenditure cuts are being imposed on all federal programs.

The New Federalism

The burden of the new federalism—both administrative and fiscal—is falling heavily on state governments. In the Northeast, with its aging infrastructure and the economy disrupted by growing imports, the reduced federal grants will impose special hardship. New York has learned painfully to live with less. We are prepared to do more to reduce public spending. However, fiscal restraint works most successfully in a growing Economy. With cuts in traditional federal economic development programs—EDA, SBA, FmHA—it is singularly inappropriate to limit revenue bonds which remain one of the few policy tools left to states.

If we are to reorganize the allocation of responsibilities among federal, state, and local governments that allows us to reduce the cost of government in equitable way, then the new federalism must be built on trust. That trust is seriously undermined by capricious bureaucratic rulings that limit the capacities of state governments with no notice and no good reason.

In summary, New York and the Northeastern state stand ready to eliminate abuses from the IDB program and to assume greater responsibility for shaping our economic future. But we urge the Administration and Congress to help us ensure that this process proceeds in the spirit of partnership. We owe it to our own state residents and to the nation as a whole to avoid the type of action that has precipitated these hearings. We hope that the IDB program will be sensibly refined and that Treasury ruling 81-216 will be withdrawn.

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COALITION OF NORTHEASTERN GOVERNORS
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(202) 624-5440

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

INDUSTRIAL DEVELOPMENT BONDS

WHEREAS, the Coalition of Northeastern Governors regards industrial development bonds as an important economic and community development tool to stimulate capital investment and employment. At a time when federal development assistance is being sharply reduced or eliminated, this financing mechanism must remain available to State and local governments as a development incentive for private investment and;

WHEREAS, we also recognize that legitimate concerns have been raised regarding abuse of small issue industrial development bonds, particularly those issued for commercial purposes.

THEREFORE, BE IT RESOLVED that the CONEG Governors recommend the following changes in federal legislation in response to that criticism:

- o Target commercial IDBs to distressed areas by providing broad federal guidelines within which States have the flexibility to determine the targeted areas based on State and local economic objectives.
- o Exempt from these restrictions special economic activities which are of particular importance to a specific State's economy and which encompass less than 5 percent of the States's economic base.
- o Exempt all production activities from research processing to warehouse-distribution from targeting limitations.
- o Establish federal monitoring and annual reporting requirements by States for all small issue IDBs issued in each State.

CONEG CONEG CONEG
COALITION OF NORTHEASTERN GOVERNORS

GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

FOR IMMEDIATE RELEASE
Monday, September 14, 1981

CONEG POLICY RESEARCH CENTER
CONTACT: Connie Saulter
(202) 624-5440

GOVERNORS SAY NO TO IRS RULING ON INDUSTRIAL REVENUE BONDS

WASHINGTON, D.C., September 11 -- Pennsylvania Governor Dick Thornburgh, Chairman of the eight-state Coalition of Northeastern Governors (CONEG) and Rhode Island Governor J. Joseph Garrahy, Vice Chairman of CONEG, have called for White House withdrawal of a recent Internal Revenue Service ruling that would eliminate the current tax exemption for state industrial development bond pools used to provide loans to small and medium size businesses. The IRS ruling, issued on August 24, would eliminate the ability of states to package a series of small business loans into a single tax-exempt "umbrella" or pooled bond issue.

In a September 9 letter to President Reagan, Governors Thornburgh and Garrahy said that the effect of the new IRS ruling will "severely restrict our ability to provide needed assistance to small firms and farm operators that are hardest hit by current high interest rates."

Governor Garrahy noted that the Northeastern states "have pioneered the use of pooled bond issues as a way of targeting tax-exempt financing to small businesses that are shut out of the private capital market." Garrahy cited recent studies which show that small businesses create more than 80 percent of all new jobs in the economy each year, a fact which has led many states to focus on the small business sector in their economic development efforts.

Governor Thornburgh called state industrial development bond (IDB) programs "a key element of our overall efforts to create new jobs and promote economic revitalization in the Northeast." "We believe this ruling is ill-conceived and represents a dramatic step in the wrong direction", Thornburgh said.

Several Northeastern states have used "umbrella" or "pooled" IDB's to finance loans to small and medium size businesses. Rhode Island this year has also initiated a similar program that has already assisted a number of small Rhode Island manufacturers.

Connecticut has issued umbrella bonds totalling $195 million over the last ten years. The Connecticut program has provided assistance to more than 500 small firms, and is estimated to support the creation of more than 9,000 new jobs annually in that state.

New York's umbrella bond program has provided loans to more than 1,200 companies, with total employment of over 90,000 workers.

The Pennsylvania Industrial Development Authority (PIDA) has issued IDB's totalling more than $92 million since 1975, the proceeds of which have financed more than 400 loans to firms employing roughly 33,000 workers. Several other Northeastern states have developed plans for issuing pooled IDB's, but have been stopped by the new IRS ruling.

The Governors expressed concern to the President that this ruling hinders possible action by Congress to enact reform legislation governing the issuance of small issue industrial development bonds. In light of this legislation, the CONEG Governors recently adopted a policy resolution developed by the CONEG Economic Development Committee, chaired by Governor Hugh L. Carey, supporting reform legislation to "ensure the responsible and targeted use of this economic development tool."

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GOVERNOR DICK THORNBURGH, Chairman
GOVERNOR J. JOSEPH GARRAHY, Vice-Chairman

September 9, 1981

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

On behalf of the Coalition of Northeastern Governors, we wish to register serious concern regarding the effects of Internal Revenue Service Revenue Ruling 81-216 on state industrial development bond (IDB) programs. This ruling, which was issued without prior consultation, eliminates the current tax exemption for multiple lots of small issue revenue bonds of less than $1,000,000 used to provide loans for small and medium size businesses. We believe this revenue ruling is ill-conceived and represents a dramatic step in the wrong direction for IDBs.

The Northeastern states have pioneered the use of so called "umbrella" or pooled bond issues as a way of targeting tax-exempt financing to smaller firms that face particular difficulties obtaining needed capital in the private market. We view the targeted use of this financing technique as a key element of our overall efforts to create new jobs and promote economic revitalization in the Northeast. The effect of this IRS ruling is to severely restrict our ability to provide needed assistance to small firms and farm operators that are hardest hit by current high interest rates.

Congress is currently considering legislative changes to establish more stringent guidelines for state and local IDB programs. In addition, the CONEG Governors recently adopted a policy resolution developed by the CONEG Economic Development Committee, chaired by Governor Hugh L. Carey, supporting reform legislation to ensure the responsible and targeted use of this economic development tool. A copy of this resolution is enclosed for your review. We believe it is a serious mistake for IRS to preempt the legislative process by suddenly reversing longstanding precedents and rulings in this area, and we strongly urge that this ruling be withdrawn.

Thank you for your consideration of this matter.

Sincerely,

Governor Dick Thornburgh Chairman Coalition of Northeastern Governors	Governor J. Joseph Garrahy Vice Chairman Coalition of Northeastern Governors

DT/lw

cc: Secretary Donald T. Regan
  U.S. Department of Treasury
 John E. Chapoton, Assistant Secretary
  U.S. Department of Treasury
 Dan Rostenkowski, Chairman
  U.S. House of Representatives, Ways and Means Committee
 Barber Conable, Ranking Minority Member
  U.S. House of Representatives, Ways and Means Committee
 Robert Dole, Chairman
  U.S. Senate Finance Committee
 Russell Long, Ranking Minority Member
  U.S. Senate Finance Committee
 Northeast Congressional Delegation

Memorandum

STATE OF NEW YORK
WASHINGTON OFFICE

September 22, 1981

TO: New York State Congressional Delegation

FROM: Brad C. Johnson

RE: IRS Ruling 81-216

IRS Ruling 81-216, issued August 24, 1981, will have a drastic negative impact on small business development throughout New York State. The ruling, which was issued without prior consultation, revokes tax exempt status for multiple lots of small issue industrial revenue bonds (IRB's) used to provide loans to small and medium businessss.

New York State is supportive of legislation which responsibly curtails misuse of IRB's. This ruling, however, penalizes the honest business along with the abuser. The ruling does not delineate between commercial and industrial bond use and represents a dramatic step in the wrong direction for IRB's.

New York's Job Development Authority (JDA) has long been a source of capitol assistance to New York's small manufacturers. This ruling will force the authority to cease marketing IRB's thus drying up an essential source of inexpensive capitol for the state's small business community. JDA assistance has been used to retain and develop employment opportunities and promote business retention and expansion. During the past 2 years JDA supplied $50 million to 250 New York firms.

Senator Weicker has introduced S. 1635 which would delay implementation of this ruling. Congressman Downey has introduced similar legislation in the House, H.R. 4507. I strongly urge you to support these measures.

For more information please call Paul Schieber in this office.

Thank you for your time and support.

BCJ:cam

PREPARED STATEMENT OF ROBERT E. PATTERSON, EXECUTIVE DIRECTOR, MASSACHUSETTS INDUSTRIAL FINANCE AGENCY

Mr. Chairman and honorable members of the subcommittee: Everyone seems to agree that the United States should direct its economic resources toward the goals of higher productivity and more jobs. An essential part of this effort has to be aid to smaller innovative companies and distressed areas.

I can speak from the perspective of five years in state government devoted to restoring the economic vitality of an old Northeastern state where the country's industrial revolution began and which today comprises about half the New England economy. Though we have a long way to go to restore our region to prosperity, Massachusetts' recovery from a 12 percent unemployment rate and countless vacant mill buildings in our historic cities has dramatically exceeded everyone's expectations back in 1975. Government incentives to induce productive private investment have played an extemely important role in this recovery despite the highest interest rates in our history.

Critical federal programs have included the Urban Development Action Grant and Community Development Block Grants administered by HUD, and incentives provided through the Small Business Administration and the Economic Development Administration. All these programs and agencies have experienced major funding reductions in the 1982 budget that went into effect last Thursday. As you well know, we probably face even more budget cuts in the future.

With interest rates still hovering at 20 percent and federal assistance to small business and urban development declining, there remains one important incentive available to state and local governments to assist growing smaller companies and distressed areas. Industrial development bonds still offer smaller companies their only real opportunity to borrow at affordable interest rates for productive investment in plant and equipment. And if responsibly targeted these bonds can provide distressed areas the most powerful development incentive likely to be around for the foreseeable future.

Now industrial revenue bonds are under major attack. The Treasury, which to my knowledge has been opposed to all tax-exempt financing with varying intensity since the introduction of the graduated income tax made that exemption valuable to state and local governments, has fired the first salvo in this year's attack by springing Revenue Ruling 81-216. This arbitrary ruling was issued without any notice or opportunity for public comment. It represents a dramatic reversal of prior IRS policy. In fact, it expressly revokes three prior rulings which have been relied on by many states in their programs to assist farmers and small business.

Underneath the technicalities of Rev. Ruling 81-216 lies a very simple practical fact. This ruling will effectively close off reasonably priced credit for growing small businessmen and farmers. It will reek havoc with the Small Business Administration's guaranteed bond program for pollution control financing, which we have been using in Massachusetts and which was just increased by Congress. And most importantly of all, it will have unbelievably unfair competitive consequences for smaller business via-a-vis their larger competitors.

I will come back to Rev. Ruling 81-216 in a moment, but first I would like to offer a few observations on industrial development bonds in general which may be timely as President Reagan has indicated that the Treasury will be proposing elimination or severe restrictions on these bonds in the very near future.

IRBs have come in for some very bad publicity recently, starting with the media reports of the Congressional Budget Office's findings and a relatively few sensational abuses. I cannot defend the way all industrial revenue bond programs have been operated throughout the country. My recent article in Commentary magazine, which was inserted in the Congressional Record by Congressman Moakley, argued that changes should be made in industrial development bonds. In my opinion the program must be more effectively targeted towards smaller companies and distressed areas or this powerful incentive will not survive.

It is critical, however, that Congress not throw out the baby with the bath water and that some reasonable discussion take place to preserve what is worthwhile and perhaps essential in the current environment of high interest rates. I would like today to point out how we have used IRBs in Massachusetts, and how important they have been to our smaller companies and distressed areas. In passing, I would also like to point out some facts contained in the CBO's report, facts which have been widely overlooked.

First, CBO found that IRBs, thanks to the $10 million capital expenditure limitation, have been used primarily to finance the growth of smaller companies. CBO found that over 90 percent of IRB recipients in 1978 and 1979 were not listed on any national or regional stock exchange. Furthermore, of some 8,000 small issues in those two years, only 7 percent went to the top "Fortune 50" non-industrial or the "Fortune 1,000" industrial firms.

In Massachusetts one-half of the industrial companies we have assisted have sales of less than $5 million, and some three-quarters have sales of less than $20 million.

Let me try to give you a better picture of what IRBs have meant to the growth of these companies. The average company with sales under $5 million borrowed $655,000 for productive assets. Since almost everything is a question of "compared to what", this new debt has to be compared with a net worth of $500,000, sales of $2 million and net income of $120,000. Considering that these companies also have other major debt, much of it at interest rates floating above the prime rate, these companies were undertaking very major expansions, borrowing over 5½ times there net income and 1⅓ times their net worth at a time of rising interest rates and widespread economic uncertainty.

There is, of course, continuing debate as to how many companies would have expanded without IRBs. Intuitively you just have to consider the figures I just recited to know that the lower IRB interest rate was important in the decision to invest in long-term productive assets. It is probably impossible, however, to know with certainty precisely what the stimulative effects of IRBs have been.

At the national level, CBO estimated in its report that IRBs will generate over $4 billion in additional gross national product in 1986. CBO's projections show that IRBs in that year will be responsible for additional private wages and salaries totaling $2.25 billion, enough to employ 150,000 people at $15,000 a year! And this stimulative effect, again by CBO's estimates, would cost the Federal Treasury (i.e. revenues which the Treasury would have to spend were IRBs to be eliminated) of only $700 million or less than $5,000 per job.

Even these cost figures estimated by CBO may be too high. Further work on this question showing substantially smaller costs to the federal Treasury has been done by Professor Kormendi at the University of Chicago Business School on a project for the Small Business Foundation of America and my agency.

I suggest that $700 million will not prove significant in 1986 in balancing the budget or bringing down interest rates. The elimination of IRBs, however, would have a devastating effect on the expansion of smaller companies until interest rates decline.

At the state level, in Massachusetts we are just completing a survey of those companies which my agency has assisted with tax-exempt financing. Surprisingly, approximately ⅓ of the companies answered even though we made it clear that the survey was completely voluntary. Of those responding fully 93.1 percent indicated that they would have been forced to alter their investments if IRBs had not been available. One-third of the companies stated that they would not have been able to expand at all without an IRB. Another third said they would have delayed their expansion without IRBs. And one-fifth said that they would have expanded less due to higher costs in the absence of IRBs.

Incidentally, these companies responding reported having already added 80 percent of the new jobs they projected at the time of starting their IRB-assisted project. In total, these projects in Massachusetts will create more than 40,000 additional jobs when completed and in full operation.

Financing of commercial enterprises with tax-exempt bonds nationally has caused, in my opinion, much of the uproar and publicity about "abuses". But we should not lose sight of the fact that, particularly at today's interest rates, the IRB incentive if restricted to distressed areas can be a powerful development tool.

In Massachusetts over the last 2½ years we have assisted 72 commercial urban revitalization developments. Though only 9 percent of our bonds, these projects represent $150 million of new investment in our older distressed downtowns. Five years ago nearly everyone told me there downtowns would never by revived in a depressed state like Massachusetts. But rather than throw away our heritage, we carved out an excellent incentive program with IRBs for these downtowns which are so important to our past and our future. We added additional state incentives and public investments, and the results have surprised even the most optimistic of us working for city revitalization.

In closing, I think it is important that everyone understand what the true effect of Rev. Ruling 81-216 will be. As Governor King of Massachusetts recently wrote to the President, "This ruling effectively closes off reasonably priced credit for small businesses while leaving the tax-exempt market available for their larger competitors. These unfair competitive effects are indefensible . . . . It is a fact that smaller, unrated companies cannot sell bonds in the public markets unless they purchase additional collateral (insurance or bank letter of credit). It is bad enough that these companies must pay higher rates to purchase the collateral they need to buy access to the national debt markets. It is unacceptable, however, that the IRS with Rev.

Ruling 81-216 should bar them from these markets on the sole technicality that the additional collateral has been purchased."

Under the guise of tax code technicalities, the Treasury is forcing small businesses out of IRBs. The reality of this ruling will be to tell smaller companies that they cannot get financing from the national credit markets. Given today's commercial banks' prime rate and the condition of the thrift industry, plus the fact that approximately one-half of the banking assets in Massachusetts are held by thrift institutions, this is tantamount to telling these companies that they can finance their real estate expansions only as tenants of big developers. Being a tenant in a big industrial park is not what most of the small businessmen I have worked with want as part of their business plan for growing, adding jobs, and investing in the future.

Finally, the CBO stated at the end of its summary on IRBs: "If the Congress eliminated tax-exemption on small issue IRBs some investments might not move forward. Others might move ahead, but changes in the amount and timing of the investment would result. Smaller firms would be the most affected. Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing."

I could not agree more with this prognosis based on my experience over the past few years in Massachusetts. Abolishing IRB will save little or no tax revenue, and I urge you to restrict the program responsibly and in the process legislatively repeal Rev. Ruling 81-216.

PREPARED STATEMENT OF INTERNATIONAL COUNCIL OF SHOPPING CENTERS, NEW YORK CITY, N.Y.

"SMALL-ISSUE" INDUSTRIAL REVENUE BONDS

The members of the International Council of Shopping Centers believe that the tax-exempt status afforded small-issue industrial revenue bonds has allowed shopping centers and other retail facilities to be built in communities that would otherwise remain without the clear economic benefits directly attributable to those facilities. These benefits include increased employment (with accompanying increases in associated employment and personal income tax revenues) and increased local and state revenues from real estate, sales, and other taxes generated by the retail centers.

Many of the shopping centers that are being built today and that are producing these economic benefits would not have been built, in light of present market conditions, without the assistance of industrial revenue bond financing. Compared with the economic benefits resulting from retail facilities, and produced by IRB financing, the costs in federal tax revenues resulting from the tax exemptions afforded interest on industrial revenue bonds are minimal or nonexistent.

The ICSC opposes efforts to restrict, at the federal level, the future availability of industrial revenue bond financing for commercial or industrial development.

I. INTRODUCTION

The International Council of Shopping Centers (ICSC) is a business association of approximately 10,000 members consisting of shopping center developers, owners, operators, tenants, lenders and related enterprises. ICSC represents a majority of the 22,000 shopping centers in the United States.

It is estimated that more than 5.9 million people are regularly employed in shopping centers and that several hundred thousand more are annually engaged in new construction. The rippling effect of shopping center development on employment in related businesses, including display advertising, maintenance and cleaning, legal and accounting, and the manufacture of goods sold in the centers, is considerable.

It is estimated that in 1980 shopping centers accounted for 41 percent of total U.S. retail sales. By the beginning of the next decade (1990), the shopping center share will likely range between 48 percent and 53 percent. In current dollar value, U.S. shopping center retail sales reached a level of $386 billion in 1980.

Clearly, the retail store and shopping center industry has a significant influence on the total United States economy.

II. THE ROLE OF INDUSTRIAL REVENUE BONDS IN SHOPPING CENTER DEVELOPMENT

As with other construction industries, shopping center development has in the past been dependent upon leveraged financing. Present market conditions have by and large dictated what we hope will prove to be a temporary end to conventional financing, and, therefore, a temporary end to conventionally financed shopping centers.

The ICSC submits that the availability of industrial revenue bond financing, with the limited tax exemption afforded under Internal Revenue Code §103(b), has allowed shopping centers and other commercial facilities to be built in communities that would otherwise remain without the clear economic benefits directly attributable to those retail facilities.

A recent survey undertaken by ICSC found that ICSC members used IRB financing for shopping center projects in twenty-three states. Ninety-four percent of the IRBs covered in the survey were for projects under 150,000 square feet of space (GLA), and in eighty-one percent of the cases, the project would not have gone forward without IRBS.

One example of such a facility is a shopping center of 175,000 square feet of gross leasable area that was developed near Altoona, Pennsylvania in 1975. It is not a grand enclosed mall with major department stores; it is a simple, small center with a discount department store, a supermarket, three restaurants, a four-screen cinema, and twelve additional tenants in a relatively small amount of space. By November 1978, the tenants of this shopping center employed approximately 300 persons. Yet this project, with its $3.5 million construction contract, almost didn't get built. During the year-long planning phase of the project, mortgage interest rates available for conventionally financed shopping centers rose from about 7 1/2 percent to almost 10 percent. At that higher interest rate, it would have been impossible for projected rents to support the debt service on the proposed shopping center. The project went forward only after IRB financing made it possible for the developer to obtain a commitment for permanent financing at 8 1/4 percent.

This shopping center, and many more like it, would have gone unbuilt but for the capital resources made possible (or at least more accessible) through IRB financing. The ICSC believes that the communities served by these facilities are economically better off today than they would have been without them.

III. ECONOMIC BENEFITS OF SHOPPING CENTER DEVELOPMENT

The extent of the contribution of shopping center development to the nation's productivity is not fully understood. Many people think of productivity solely in terms of the process leading directly to the manufacture of goods. Others would broaden the concept enough to include the distribution of those goods to the loading docks of the nation's retail facilities--but not to the distribution of products to the ultimate consumer. The fact is, of course, that retail facilities, as the final link in the chain of distribution, are an integral part of the productive process.

Furthermore, shopping centers generate jobs and significant municipal revenues in a number of ways. Sales taxes and real property taxes are two of the largest sources of state and local revenue attributable to shopping centers. Other direct contributions to local treasuries include business license revenues and personal property taxes on such things as office and retail equipment and inventories. Of course, increased employment in the construction and operation of a shopping center represents a very tangible benefit to the community.

Employment. The ICSC has estimated that the tenants of shopping centers employ one full-time employee for every 400 to 500 square feet of gross leasable area space. Thus, the Altoona shopping center of 175,000 square feet described above employs 300 people. Many of these 300 people, as recent entrants into the job market, would have been unemployable or marginally employable in industrial positions.

Furthermore, figures compiled by the New Jersey Economic Development Administration demonstrate that, at least in that state, IRB financing for commercial projects is a more effective means of creating permanent jobs than all other uses of IRB financing. As figure 1 indicates, the number of permanent jobs created per $1.0 million of industrial revenue bond financing for commercial projects (including retail facilities) was approximately one-third higher than the number of industrial jobs generated by the same dollar amount of IRBs.

Figure 1.

Project Type	Total New Jobs* 1980	Total 1980 Industrial Revenue Bonds Issued in Support of Projects ($000)	New Permanent Jobs per $1.0 Million of IRBs
Commercial (including retail)	1,613	$ 52,181.1	30.9
Balance of Projects, Excluding Office and Investment in Quasi-Public Utilities	11,131	$478,334.4	23.3

*Permanent (excludes construction).

Source: New Jersey Economic Development Administration, 1980 Annual Report 15-21.

Tax Revenues. It is difficult to dismiss the economic impact of shopping center development in local communities when one looks beyond abstract projections of sales tax revenues and the like and considers the empirical data on the actual performance of shopping centers. For example, a 1975 study published by ICSC included a twelve-year case history of the fiscal impact of a large shopping center in Oak Brook, Illinois.

The Oakbrook Regional Shopping Center is no more typical of the diverse facilities developed by ICSC members than any one shopping center can be. Nevertheless, the Oakbrook study suggests generally the powerful fiscal influence shopping centers can exert.

During the period from 1963 through 1973, the Oakbrook shopping center was the primary source of sales tax revenue for the Village of Oak Brook, Illinois. The shopping center's share of total municipal revenues ranged from a high of 91.3 percent in 1965 to 75.4 in 1973 (the last year for which the study developed data). Even after taking into account the increase in municipal tax expenditures attributable to the shopping center's presence in Oak Brook (for example, increased police and fire protection and local road maintenance), the ICSC study found that in 1973 Oak Brook received net cash-flow benefits in excess of $1.2 million directly attributable to the shopping center. Without this net revenue source, the report concludes, "Oak Brook would have had a deficit which would require either a decrease in expenditures or another income source. Current studies conducted by the village further indicate that a property tax will not be required until at least 1980. However, without the shopping center such a tax probably would have been mandated by 1973 or 1974 if current levels of municipal expenditures were maintained."1/

Although the Oakbrook Regional Shopping Center was built without the assistance of IRB financing, it was built

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1/ Levin, Measuring the Fiscal Impact of a Shopping Center on its Community 30. International Council of Shopping Centers, 1975.

at a time when market conditions made such financing unnecessary. Today's developer of retail facilities is not so fortunate. For example, ICSC member M.H. Hausman Co., an Ohio developer of commercial facilities, has built two shopping centers in the past year with industrial revenue bond financing. The company reports that neither of these facilities would have been built if the sole financing method available to the company had been conventional mortgages with the prevailing interest rates of 14 to 15 percent.

A quick review of the income and expenses associated with one of M.H. Hausman's shopping centers illustrates why such a conclusion is inevitable. The company's Columbia-Detroit shopping center in Westlake, Ohio, comprising some 50,000 square feet of gross leasable area, was financed through a $2.0 million IRB mortgage bearing an interest rate of 7 1/2 percent.

As figure 2 shows, the annual debt service of $181,632 on the mortgage, combined with general and miscellaneous expenses, yields a net annual cash flow to the shopping center owner, after deduction from rental income, of $34,197. A 14 percent mortgage, on the other hand, would result in an annual debt service of approximately $289,000. That mortgage expense would, even with all other expenses remaining the same, produce an annual loss in excess of $74,000, and would therefore have dictated that the Columbia-Detroit shopping center not be built.

Figure 2.

	IRB Financing		Conventional Mortgage Financing	
INCOME				
Fixed Rent		$220,176		$220,176
EXPENSE				
Mortgage	$181,632[a]		$289,000[b]	
General Expense-Net Recovery	3,800		3,800	
Miscellaneous Expense	2,400	187,832	2,400	295,200
Net Cash Flow (Loss)		$ 34,197		$(74,824)

a/ $2,000,000 principal amount, 7 1/2 percent interest, 24 year term.
b/ $2,000,000 principal amount, 14 percent interest, 25 year term.

A similar analysis of income and expenses for the second of M.H. Hausman Co.'s IRB-financed projects reflects the same devastating effect of high mortgage interest rates. The company estimates that, when completed later this year, its Crossroads Plaza in Saybrook, Ohio, with more than 70,000 square feet of gross leasable area, will produce a net cash flow of $39,358. Replacement of the 7 1/2 percent IRB-backed mortgage with a 14 percent mortgage would transform that figure into a net loss of $115,442 per year.

Of course, it might be argued that these illustrations show nothing more than that present market conditions justify higher rents to offset a developer's rising mortgage costs. As a practical matter, however, tenants of retail facilities are strictly limited in their ability to bear the burden of increasing financing costs.

In deciding whether or not to lease space in a proposed shopping center, prospective tenants invariably focus on their projected return on investment. Although methods vary from one retailer to the next, analyses of returns on investment consider such factors as the estimated sales in the proposed facility, the expense of doing business, the anticipated profit, and a comparison of that profit to the total investment to be made in the new facility.

Clearly, rent is an important component of a tenant's expense of doing business. Thus, a proposed shopping center that cannot keep lease payments within the range required by a prospective tenant's return-on-investment analysis will not get built or will be delayed until interest rates fall to a level that will allow for rents which will permit the retailer to operate at a profit.

In the interim, people who could have been working will not be working, personal and business income taxes that could have been collected will not be collected, state and local taxes that could have been collected will not be collected, and so on.

The ICSC believes that these illustrations are typical of the conditions existing throughout the industry. The net effect, therefore, of eliminating or reducing the availability of small-issue IRB financing for retail facilities will be a substantial reduction of new construction starts in retail facilities. Concomitant with that reduction will be the loss to local treasuries of significant tax revenues. For example, the two relatively small shopping centers built by M.H. Hausman Co. discussed above are expected to generate total combined real estate and sales taxes of approximately $67,000 per year at full occupancy. Of course, that $67,000 is calculated without regard to the very significant local revenues arising out of increased employment (estimated at 250 to 300 new jobs) and the secondary development that may be spurred by the introduction of the new retail facilities.

The ICSC believes that IRB financing provides developers of shopping centers and other retail facilities with an opportunity that might not otherwise exist to increase the quality of life in local communities in at least as efficient and effective a manner as the IRB financing of industrial facilities.

IV. FEDERAL TAX REVENUE IMPACT OF SMALL-ISSUE INDUSTRIAL REVENUE BOND FINANCING

It is clear from the Congressional Budget Office study released in April of this year that the CBO does not share the ICSC's enthusiastic outlook on the economic benefits to be derived from small-issue industrial revenue bond financing. The CBO asserts that the net revenue gain to be derived from elimination of the tax exemption for such IRBs would total $2.5 billion over fiscal years 1981 through 1986.

A study prepared last year by economist Norman B. Ture reaches conclusions that stand in marked contrast to those of the CBO. In the course of his study, Ture considered the extent to which federal tax revenues would be affected by the elimination of the tax exemption for small-issue IRBs. According to Ture,

> there are two ways of measuring changes in the Federal tax revenues in response to a change in the law. Initial impact estimates measure returns under the unrealistic assumption that there are no changes in economic activity in response to the tax change. On this assumption, the volume of private investment is unaffected by the amount of IDBs issued, implying that each additional dollar of IDB-financed investment displaces a dollar of taxable bond--or equity--financed capital outlay. On this basis there would be a slight revenue loss--less than $50 million--in 1989. If the amount of IDBs were deemed to be associated with additional investment--*that is with investment which otherwise would not be undertaken*--the initial impact revenue effect would be zero, since no displacement of other financing, by hypothesis, would have occurred. The alternative net-of-feedback measure takes into account changes in economic activity in response to the tax change and the effects of these changes in the economy on tax bases. In this instance, additional IDB financing results in net additions to the volume of capital formation, rather than displacement of taxable-bond-financed investment. As shown, *this additional investment leads to gains in output and income*.2/

Clearly, the experiences of ICSC's membership bear out Dr. Ture's conclusion that "IDBs are productive instruments for promoting economic development by making saving and investment more attractive to individuals and businesses. Their use results

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2/ N. Ture, A Report Prepared for the National Committee on Small Issue Industrial Development Bonds: Economic and Federal Revenue Effects of changes in the Small Issue Industrial Bond Provisions 10 (1980) (emphasis added).

in overall gains in capital formation, employment, and output, rather than merely changes in the location of economic activity."[3] Finally, Ture recommends, and the ICSC supports him in his recommendation, that the existing $10 million capital expenditure limit be raised to increase the number of projects eligible for IRB financing, an action that would "expand total capital outlays, employment, and real GNP."[4]

In testimony before the Oversight Subcommittee of the House Ways and Means Committee on April 8, 1981, Roger C. Kormendi of the University of Chicago challenged certain assumptions upon which the CBO based its estimates of the net loss to the federal treasury associated with IRBs. Kormendi, in a report prepared with Thomas T. Nagle, concluded that

> the cost of IDB financing in foregone federal tax revenues is on the order of $4 to $6 million... for each billion dollars of new IDBs when taxable interest rates are in a range of 10% to 14%. These estimates contrast sharply with the CBO's recent estimates of $30 to $40 million for each billion dollars of bonds.[5]

Furthermore, according to Kormendi and Nagle, their estimates of revenue loss

> imply that each dollar of interest saving for IDB borrowers costs the U.S. Treasury approximately 15 cents in federal tax revenues. Thus IDBs are more than six times as efficient as direct subsidies, which cost the U.S. Treasury one dollar

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[3] Id. at 11.
[4] Id. at 11-12.
[5] R. Kormendi and T. Nagle, A Summary of the Nature and Effect of Small-Issue Industrial Development Bonds 1 (1981).

> for each dollar of benefit. This conclusion contrasts sharply with the Treasury's claim that each new dollar of interest saving for IDB borrowers costs the U.S. Treasury $1.33 in federal tax revenues.6/

It is important to note that these estimates of revenue loss are not, as Ture would say, "net-of-feedback." Kormendi and Nagle point out that

> Tax revenues depend not only on tax rates but also on the tax base. Anything that encourages the tax base to expand will result in a higher feasible level of tax revenues in the future. The lower capital cost provided by the interest tax exemption will almost certainly lead to more investment and growth of the small business sector (and it certainly will not result in less growth). Hence, sales, property, and income tax revenues are likely to grow concomitantly. Therefore, the tax revenue loss we have estimated can only be an upper bound.7/

If nothing else, the views expressed by Ture, Kormendi and Nagle suggest the need for caution in analyzing the economic effects of industrial revenue bonds.

V. LEGITIMATE CRITERIA FOR EVALUATION OF THE TAX EXEMPT STATUS OF SMALL-ISSUE INDUSTRIAL REVENUE BONDS

The ICSC would argue that any decision to preserve or eliminate the tax exemption for small-issue industrial revenues should be made solely on economic merit. The ICSC membership is satisfied that a legitimate cost-benefit analysis, considering

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6/ Id.

7/ R. Kormendi and T. Nagle, The Nature and Effects of Small-Issue Industrial Development Bonds 55-56 (March 30, 1981).

all issues relevant to ultimate impact on the national economy,would dictate not only the preservation, but the expansion, of the present tax exemption.

If it is correct that minimal or no net loss to the federal treasury arises from the availability of small-issue IRB financing, no other legitimate policy consideration would be served by curtailing access to that source of capital. At the very least, it would be inappropriate for IRB critics to pursue some hidden philosophical goals, whatever those may be, disguised as a legitimate effort to reduce federal budget expenditures.

Moreover, the CBO's recent study reflects the diverse criteria among states for the appropriate uses of IRBs within their borders. So long as the federal interest in governing IRB use is as minimal as the net effect of IRBs on the federal treasury, ICSC believes that the federal government should decline to engage in efforts to impose uniformity on the states' exercise of their authority to issue IRBs. If individual communities and states, as major benefactors of the increased revenues attributable to commercial development, choose to encourage particular types of commercial and industrial development, their will need not and should not be supplanted.

VI. RECOMMENDATIONS

It is clear, both from the CBO's acknowledgment of the inadequate data underlying its recent report and from the ICSC's own efforts to develop comprehensive information on the use of IRBs, that Congress cannot now be fully informed on the economic merits of IRB financing. The ICSC therefore recommends that reporting requirements be imposed at the state level on all users of industrial revenue bonds. As a condition of continuing the tax exemption of Internal Revenue Code §103(b), lenders could, for example, be required to report annually information on the amounts of IRB financing provided; the number of jobs created per million dollars of IRB issuance; wages, FICA taxes, and federal, state and local income taxes associated with these jobs; and property taxes and sales taxes generated by IRB-financed projects.

The membership of the ICSC offers a general recommendation that Congress encourage the greater use of IRBs, whether through increased capital expenditure limits or other means, to finance commercial and industrial projects.

ICSC also submits that certain provisions of Internal Revenue Code §103(b) have imposed inequitable and unnecessary conditions on the availability of IRB financing. The current $10 million capital expenditure limit applies, under §103(b), to all facilities that are (1) located in the same municipality or county and (2) associated with the same principal user or users.[8]

The first of these criteria, the jurisdictional limitation of §103(b), should be modified to allow additional capital expenditures for industrial or commercial projects in areas where higher population would suggest a greater demand for those projects. The ICSC recommends, therefore, that the Congress respond to the needs of those populous communities by permitting higher capital expenditure limits in jurisdictions where population levels exceed a specified level.

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[8] I.R.C. §103(b)(6)(E).

A Summary of
THE NATURE AND EFFECTS OF SMALL-ISSUE INDUSTRIAL DEVELOPMENT BONDS

by

Roger C. Kormendi
Thomas T. Nagle
University of Chicago

This study examines several issues related to the use of Industrial Development Bonds (IDBs). Much of the analysis and many of the conclusions in this study differ from widely cited studies by the Congressional Budget Office and the U.S. Treasury. Our purposes in this study are (1) to develop a more realistic view of the way capital markets adjust to small-issue IDB financing and (2) to derive estimates of the effects of IDBs that are consistent with this more realistic view. Our findings are the following:

- The cost of IDB financing in foregone federal tax revenues is on the order of $4 to $6 million dollars for each billion dollars of new IDBs when taxable interest rates are in the range of 10% to 14%. These estimates contrast sharply with the CBOs recent estimates of $30 to $40 million for each billion dollars of bonds.

- These revenue loss estimates imply that each dollar of interest saving for IDB borrowers costs the U.S. Treasury approximately 15¢ in federal tax revenues. Thus IDBs are more than six times as efficient as direct subsidies, which cost the U.S. Treasury one dollar for each dollar of benefit. This conclusion contrasts sharply with the Treasury's claim that each new dollar of interest saving for IDB borrowers costs the U.S. Treasury $1.33 in federal tax revenues.

* The reason the widely cited CBO and Treasury figures are so inflated is that they are based on assumptions about investors' portfolio holdings that simply do not conform to the facts. Their analysis is equivalent to assuming that newly issued IBDs are absorbed only by investors around the 30% marginal tax bracket and that when those investors purchase tax-exempt bonds only fully taxable bonds are replaced. In fact, newly issued IDBs are generally absorbed by the full spectrum of investors above the 30% tax bracket, replacing in those investors' portfolios assets such as equity that, like tax-exempt bonds, are only partially taxed. The equity released by high tax bracket investors is in turn absorbed by the full spectrum of lower tax bracket house-holds and non-taxed institutions in lieu of taxable bonds.

* Inflation causes a shift of funds out of taxable bond markets into tax-exempt bond markets. This is because under current tax law taxes are levied not only on "real" interest income but also on that part interest income that simply compensates investors for the effects of inflation. Thus, funds that would otherwise be available for financing private investment through taxable bond and loan markets are diverted by inflation into tax-exempt bond markets, which traditionally have been the exclusive domain of public borrowers. The result has been a substantial reduction in tax exempt interest rates relative to taxable interest rates corresponding to the higher rates of inflation in recent years. IDBs offer the only currently available avenue for private investment projects to regain access to the funds diverted to tax-exempt markets as a consequence of inflation.

- Tax exempt revenue bonds have often been alledged to disrupt tax exempt bond markets by significantly driving up tax exempt interest rates. One estimate that has been widely cited by both the CBO and the Treasury claims that each additional $1 billion of tax-exempt bonds would raise tax-exempt interest rates by 5 to 7 basis points. Our study finds that when lagged portfolio adjustments, the effects of inflation, and the integrated structure of capital markets are all properly accounted for, the effect of each additional $1 billion of tax-exempt bonds is only 0.6 basis points, or approximately one-tenth the widely cited estimate.

IMPORTANT FACTS ABOUT INDUSTRIAL REVENUE BONDS

The Congressional Budget Office (CBO) has issued its long-awaited study on small issue industrial revenue bonds. This study and testimony at the House Ways and Means Oversight Subcommittee hearings have produced some important findings about IRBs.

-- 1) By CBO's own estimate (CBO p.45), the amount of federal revenue which could be raised by eliminating all IRBs as of July 1, 1981, would be only $.2 billion in 1982, rising slowly to $.7 billion in 1986. If all IRBs for commercial projects were eliminated, CBO estimates that only $40 - $50 million of additional federal revenues would be generated in FY 1982.

These numbers are vastly smaller than the gross CBO "revenue loss estimates" carried by the newspapers. These "revenue loss estimates" are misleading because they fail to take account of CBO's own estimates of increased investment, gross national product and federal tax revenues created by lower IRB interest rates.

-- 2) By CBO's own estimate (CBO p.96), IRBs issued between now and 1986 will in that year produce over $4 billion of additional GNP, including $2.2 billion in increased private wages and salaries, enough to employ 150,000 people at an average wage of $15,000 per year.

Again by CBO's own estimates, this increase in jobs, private investment and income will be achieved at the "cost" of only $700 million to the Treasury, making IRBs the federal government's cheapest employment-producing program at less than $5,000 per job.

-- 3) But CBO's cost estimates are greatly exaggerated, as shown by testimony presented at the Oversight Subcommittee hearings by economist Roger Kormendi of the University of Chicago Business School. Adjusting the CBO's estimates to reflect more accurate assumptions, Mr. Kormendi found gross revenue "losses" of approximately 1/6th CBO's estimates.

If the CBO's estimated increases to GNP and federal tax revenues (CBO p.45) are added onto these adjusted estimates, then the IRB program may actually be producing net revenue gains for the Treasury.

-- 4) CBO found that IRBs, though originally designed to lure industry to the South, have recently helped companies to grow in the Frostbelt. Two-thirds of all IRB sales in 1979 were for projects in the Northeast and North Central regions (CBO p.27).

-- 5) CBO found that IRBs are overwhelmingly used by smaller companies. CBO reported that over 90% of the firms using IRBs in 1978 and 1979 were not listed on any national or regional stock exchange (CBO p.21). Of some 8,000 small issues in those two years, only 7% went to the top "Fortune 50" non-industrial companies or the top "Fortune 1,000" firms (CBO p.23).

-- 6) Despite increases in tax-exempt bonds to finance housing and industry, CBO notes that in recent years the difference between tax-exempt and taxable interest rates have widened from the historic 30% to nearly 40% (CBO p.17). In other words, tax-exempt interest rates have not risen as rapidly as taxable rates despite the inflation of the past few years. Given this fact it is hard to claim that an increase in IRBs has substantially increased the cost of borrowing to state and local governments.

Mr. Kormendi estimates that each $1 billion of additional tax-exempts may raise the cost of state and local government borrowing by only 6/1000ths of a percentage point -- while also raising state and local tax revenues from the projects financed by IRBs.

-- 7) CBO's summary concluded that if Congress were to eliminate IRBs, "smaller firms would be the ones most affected. Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing" (CBO p.xviii).

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Robert E. Patterson
Executive Director

IRBs IN MASSACHUSETTS

Just six years ago, the Massachusetts economy was suffering badly. The state's unemployment rate was 50 percent above the national average, while personal income ranked third lowest in the nation when adjusted for our higher cost-of-living and taxes. In addition, our downtown commercial centers had deteriorated from a lack of private investment.

Today, however, Massachusetts enjoys an unemployment rate that has consistently been several points below the national average during the latest recession. The state has been vying with Texas for the lowest unemployment among the ten major industrial states. Manufacturers' capital investment in the state has increased 60 percent over the past two years, and personal income is rising at a faster pace in Massachusetts than the national average for the first time in a decade. Moreover, our downtowns are enjoying an economic rebirth as interest in urban development has been revived.

The responsible use of industrial revenue bonds (IRBs) for growing businesses and urban revitalization developments has played an important role in this dramatic turnaround. The Massachusetts Industrial Finance Agency (MIFA), has worked to help growing firms, especially smaller ones, to obtain low interest IRB loans. The agency has also made these loans available for commercial projects that contribute to the revitalization of the state's downtown commercial centers.

Some facts on MIFA:

-- In the past 2½ years the agency has approved over $750 million in IRB loans for over 500 growing employers who will add more than 25,000 new workers to their payrolls.

-- MIFA loans are primarily used for smaller companies. Of the industrial companies assisted by MIFA, one-half have annual sales of less than $5 million, and two-thirds have sales of less than $20 million. These companies do not have access to national credit markets for capital, and must rely on commercial and savings banks for their loans. In these times of volatile interest rates, these companies might not be able to expand without the lower IRB interest rate.

-- Massachusetts, unlike many other states, allows IRBs for commercial (as opposed to industrial) projects only if located in designated Commercial Area Revitalization Districts, primarily in the downtowns of our communities. These bonds have been critical to revitalizing many of our older cities and towns, and Congress has chosen to favor distressed areas by a special provision for IRBs used in conjunction with UDAG funds. Massachusetts ranks third in the amount of UDAG funds awarded to all states.

-- The $900 million of capital investment and 25,000 jobs stimulated by IRBs in Massachusetts have increased local, state and federal tax revenues.

The responsible use of IRBs has been extremely important in Massachusetts' economic resurgence, and any efforts to restrict IRBs nationally with a state by state limit must be defeated. In 1980 Massachusetts was the sixth largest issuer of IRBs in the country.

U.S. Department of Labor

Employment and Training Administration
601 D Street, N.W.
Washington, D.C. 20213

file

JUL 9 1981

JUL 16 1981

Honorable Henry J. Nowak
House of Representatives
Washington, D.C. 20515

Dear Congressman Nowak:

This is in response to your letter of June 12, 1981, requesting information concerning shortages of skilled labor for the machinery industry.

The U.S. Employment Service maintains two information programs which may be of assistance to you. Both of these resources would require a more precise identification of what occupational areas are included under the broad heading of the machinery industry.

Through the use of the Job Bank Openings Summary Report (JBOS) we may be able to provide you with needed information. Local Job Service offices affiliated with the U.S. Employment Service maintain records of job openings which have been listed by employers. Almost all local Job Service offices maintain a computerized record of the openings, called Job Bank. Each month these records are developed into a national summary report called JBOS. Information is presented by both occupational and geographical area. The data base for the JBOS report can be reviewed for those employer orders which are relevant to the occupations included in the machinery industry.

The second information source which may be applicable to your needs is the Employment Security Automated Reporting System (ESARS). Among the types of information available are total job openings received and filled by two-digit Standard Industrial Classification (SIC) code. Also statistics are available cross tabulated by one-digit Dictionary of Occupational Titles (DOT) code and one-digit SIC code for openings received and filled by State. Finally, some selected information is available by nine-digit DOT code for applicants available and job openings received.

Because of the need to have a more precise identification of what occupations or occupational areas are included in machinery occupations, and the need to develop specifications for computerized data search, it may be advisable to have a member of your staff meet with representatives of the U.S. Employment Service to develop the particulars of the information development. I would suggest that initial contact be made with Al Berndt, Acting Chief of the Division of Occupational Analysis on telephone (202)376-6292.

We look forward to cooperating with you and your Committee on this project.

Sincerely,

David O. Williams

DAVID O. WILLIAMS
Administrator
U.S. Employment Service

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October 7, 1981

LEGISLATIVE

UPDATE:

- INDUSTRIAL REVENUE BONDS -

In a special budget message to the nation last month, President Reagan announced his intention to eliminate "abuses and obsolete incentives" in the federal tax code. Among the categories being reviewed by the Treasury Department for possible inclusion in a formal tax bill is "the use of tax-exempt industrial development bonds."

Both the House and Senate are now awaiting delivery of a formal White House proposal, which is not expected until October 20th at the earliest. Given the Congressional recesses scheduled for Thanksgiving and Christmas, it is very unlikely that final action on such a controversial measure could be completed this calender year.

However, supporters of IRB's are urged to immediately begin communicating with their elected Representatives in the House and the Senate. The congressional reaction to the White House proposal will largely depend on the action IRB supporters take between now and the time the Administration's tax package is formally considered on the Hill.

On a related matter, the Treasury Department continues to hold firm on an Administrative Ruling (I.R.S. Ruling 81-216) which will severely limit the use of small-issue IRB's of under $1 million which are offered in composite "umbrella" bonds by state agencies. Despite strong protests from small-business groups, agriculture interests and the National Governor's Association at its annual Conference, the Treasury Department has made only minor changes in its proposed I.R.S. ruling which would still effectively eliminate the use of such bonds retroactively from August 24th of this year.

Bills which would postpone the I.R.S. ruling until 1983 have been introduced in both houses -- in the Senate by Republican Lowell Weicker (S. 1635) and in the House by Congressman Frank Guarini (H.R. 4567), as well as several other Congressmen. Hearings have been held by the Senate and House Small Business Committees on this issue, which have attracted an alliance of rural and urban state, local and small business groups. On october 14th and 15th, the House Small Business Subcommittee on Tax, Access to Equity Capital and Business Opportunities will hold two days of testimony on IRB's, with opportunity for written testimony from all interested parties.

No action has been taken on either of these bills, which are co-sponsored by Senate Finance Committee member Durenberger and introduced by House Ways and Means Committee member Frank Guarini. Republicans Lowell Weicker, David Durenberger, and Ted Stevens of the Senate, together with a bi-partisan coalition in the House, have also led lobbying efforts within the White House and Treasury to postpone the I.R.S. ruling, so far with no success.

If the Administration's stance on small-issue IRB's is any indication of its position on larger-issue IRB's, supporters are warned to expect a very restrictive proposal as part of the White House Tax Bill. Thus, it is especially important to begin to write, call, telegram, and visit personally with your Senators and Congressmen on this issue before the Administration delivers its formal proposal to the Hill.

If you have any further questions on the above material, please feel free to contact Barbara Kates of our staff.

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OKLAHOMA BAR ONLY

October 12, 1981

Congressman Henry J. Nowak
Chairman
United States House of Representatives
Committee on Small Business
B-363 Rayburn House Office Bldg.
Washington, D.C. 20515

Re: Subcommittee Hearings on Small Issue Industrial Development Bonds, October 14, 1981

Dear Congressman Nowak:

It is with sincere regret that I must notify your office that I will not be able to appear before your Subcommittee on Wednesday, October 14, 1981 to testify on the subject of Small Issue Industrial Development Bonds. The continuous flood of rumors in Washington and on Wall Street in New York concerning the pending threat that legislation will be introduced this week to kill Small Issue Industrial Development Bonds has caused several of my major clients to call special meetings on Tuesday, Wednesday and Thursday in Louisiana for purposes of being brought up to date on this very vital matter. These meetings will require me to remain in Louisiana.

The State of Louisiana has effectively and intelligently utilized Small Issue Industrial Development Bonds for the economic and industrial development of the State. As General Counsel to the Louisiana Public Facilities Authority, I am extremely interested in having an opportunity to provide input to your Subcommittee on this subject. I sincerely hope that I will have the opportunity in the near future to appear before your Subcommittee in the event you elect to hold additional hearings on this very important matter.

Sincerely yours,

McCOLLISTER, McCLEARY, FAZIO,
MIXON, HOLLIDAY & HICKS

Steve E. Hicks

saj
cc: Congressman Buddy Roemer
Louisiana Public Facilities Authority

THE SUN

BALTIMORE, TUESDAY, OCTOBER 13, 1981

Fearing U.S. cutoff, city to seek $692 million in industrial revenue bonds

By Sandy Banisky and Pamela Constable

City officials, fearing an imminent federal cutoff of industrial revenue bonds, yesterday rushed to prepare bills authorizing $692 million in IRBs—more than three times the amount the city approved all last year.

In what some were calling "the Columbus Day bond-a-thon," city aides hastily compiled 62 proposals to use the bonds for projects ranging from parking lots to hotel renovation.

As many as 20 more proposals are expected this morning.

The Schaefer administration and its allies in the City Council are planning to rush the bonds through a multi-stage authorization process before Thursday, the date they fear a ban on IRBs will become effective. Once the bonds are approved by the city, the beneficiary has a year to sell them.

IRBs have become increasingly popular finance tools for urban development because they offer the lure of low interest rates to the seller—usually a private concern—and tax-free interest to the buyers.

While the city authorizes them, its faith and credit do not back them up.

In the last two years, Baltimore city's use of IRBs has leaped from $8.4 million in 1979 to $186 million in 1980.

Walter S. Orlinsky, the City Council president, said yesterday's avalanche of bond requests left him "totally aghast." He and Councilman George W. Della, Jr. (D, 6th) said they would seek a city solicitor's opinion on the size and nature of the applications.

And in Washington, a House of Representatives legal adviser said he thought Baltimore and other cities rushing to beat a rumored federal cutoff of bond authority are "overreacting."

It was not just the volume of yesterday's requests that was unusual. Some of the applicants included:

- The city trustees, seeking $20 million. The trustees, who operate a quasi-public $100 million loan and loan guarantee program, plan to borrow under the name "The City Loan and Trustee Project." That entity would "loan the proceeds to the trustees for loans and guarantees by the mayor and City Council of Baltimore."
- The Lexington Market, for $20 million. The borrower would be "Baltimore City Markets Project"... "in order to loan the proceeds to Lexington Market, Inc." for improvements.
- The Baltimore City Foundation Project, for $10 million, that would be used "for the sole and exclusive purpose of financing the acquisition of certain neighborhood facilities."

What is the Baltimore City Foundation Project? "I have no idea," said Mr. Orlinsky after he heard of the last-minute rush.

- Baltimore City Hospitals, the city's financially ailing East Baltimore facility, for $10 million.
- Marina Foundation Waterfront Project, which is seeking $10 million "for the purpose of financing the acquisition of certain waterfront facilities."
- BEDCO Development Corporation Project, for $15 million, to be used for "certain economic development facilities."
- BEDCO Economic Development Project (not to be confused with the previous listing) for another $15 million loan authorization.
- $300 million to the Baltimore Economic Development Corporation for development of the Park Circle, Holabird and Seton industrial parks and the Holabird Foreign Trade Zone.

WALTER S. ORLINSKY
..."totally beyond the parameters"

GEORGE A. PIENDAK
...budget director admits "risk"

Mr. Orlinsky said yesterday's blitz of bills was "totally beyond the parameters of what I expected. I'm totally abashed at the volume and nature of what happened today."

Last week, he said, he had agreed to accept dozens of loan proposals in what he understood was merely a speeded-up processing of normal applications.

This morning, Mr. Orlinsky said, he will ask the city solicitor to rule on the legality of a quasi-city agency—such as the trustees—using city authorization for low-interest loans.

"I know they're going to say the city trustees aren't the city," he said. "But for all intents and purposes, the trustees are the city. I tolerate legal fictions for what they are—legal fictions," Mr. Orlinsky said.

Meanwhile, in Washington, the counsel for the House Ways and Means Committee said he thinks Baltimore and other cities are "overreacting" in rushing to meet a deadline that "does not even exist."

Both a House subcommittee and Reagan administration officials have been studying possible limitations on IRBs, but neither group has yet made any firm decisions, said John J. Salmon, chief counsel for Ways and Means.

George A. Piendak, the city's budget director, said the city is merely protecting itself against a possible congressional prohibition or limit on IRBs.

"We're taking everything that's in the pipeline and taking a calculated risk," Mr. Piendak said. "Either we'll look good or we'll look a little foolish.

"Just because they'll go through the process doesn't mean they'll all be used," Mr. Piendak said. "It's just protection for us. We'll be ready in case Congress cuts us off."

Many of the loan requests filed yesterday in the City Council showed signs of the speed with which they were assembled. Many listed no bond counsel, meaning the principals in the company were not far enough along in their project to have secured a lawyer.

And many of the applications described the projects only in the most general terms. Some did not even list addresses for the property that the companies say they plan to buy.

"All of the standard business ones will

See BONDS, A8, Col. 4

THE SUN, Tuesday, October 13, 1981

Fearing U.S. cutoff, city to seek $692 million in industrial bonds

go in, and we'll try to accommodate them as quickly as sanity allows," Mr. Orlinsky said.

"But I don't think we should act on some of these until the neighborhoods hear about them and get a chance to comment," he said.

Some of the other loan authorization requests included:

- $2 million to Food-a-Rama for the purchase and improvement of two abandoned Pantry Pride stores—one on York road and one on Frankford avenue.
- $10 million to Federal Hotel Corporation for the renovation of the Lord Baltimore Hotel.
- $3.5 million to the New Vision, Inc., Project, for the development of a subscription television company.
- $8.5 million to the David H. Murdock Development Corporation for a 750-space parking facility in its recently announced Light street development.
- $10 million to the May department stores for renovation of the Hecht's Howard street store.
- Occidental Petroleum Corporation Project, for $67 million for a coal pier in Curtis Bay.

Generally, small-issue IRBs are limited to $10 million, but city officials said yesterday that several proposed projects over that amount are legal.

- East Ridge Tenants Association, for $15 million to help tenants at a dilapidated East Baltimore apartment complex purchase it and convert it to a cooperative.
- Coldspring Terrace Limited Partnership, for $6 million, to develop a housing complex in Northeast Baltimore. City officials recently failed to secure a federal grant for this project.
- Trinity Place Limited Partnership, for $4 million, for renovation of rental properties in Little Italy.
- Heptasoph Limited Partnership, for $9 million, for "certain real properties in Batlimore city."
- Queen Manor Nursing Home, Inc., for $1.5 million to make improvements and buy machinery.
- Barclay-Greenmount NSA Limited Partnership, for $6.5 million.
- WBH Realty Company, Brown's Supermarket, $1.2 million to develop the auto center at the abandoned North avenue Sear's store.
- March Funeral Home, $1 million to buy and develop property in the 5300 block Reisterstown road.
- Imperial Square Associates Parking Facility, for $5.93 million for a garage at Lombard, Paca and Eutaw streets.

Yesterday, Columbus Day, was a paid holiday for city employees. But the city treasurer's office and the City Council suite were busy all day, with staff members writing IRB applications in the form of ordinances for submission to the Council.

This morning, the city's Board of Finance will meet to review the applications, sending the ones it approves to the Board of Estimates, which has scheduled a special session today to accept the files.

This afternoon, the City Council will receive the ordinances authorizing the IRBs

But before an ordinance can be approved, it must have a public hearing. Mr. Della, the chairman of the Council's Budget and Finance Committee, has scheduled a marathon session, beginning at 8:30 tomorrow morning, to allow public comment on each of the bills.

He intends to allow 10 minutes for each IRB request. At that rate, the hearings could last more than 13 hours. Then, the Council must convene another special meeting to approve the applications it deems worthy.

If the Council acts before midnight tomorrow, the city will have beaten the congressional deadline it expects Thursday.

"Will you be my witness for the Guinness Book of Records?" Mr. Della asked, smiling, as he contemplated tomorrow's dawn-to-dark hearings. "More IRB's passed in one day than any other municipality."

Mr. Salmon, the Ways and Means counsel, said many cities and towns have been "rushing to meet a deadline that is not clear and not decided. I think they're overreacting to a lot of rumors that have been floating around the financial community."

Mr. Salmon was referring to two plans to limit the use of "small-issues" IRBs, now being independently considered by the Treasury Department and by the Ways and Means subcommittee.

Ways and Means has been conducting extensive inquiries into local misuse of IRBs, but the subcommittee has not yet even made its report to the full committee, he said.

"We've been primarily concerned about the misuse of IRBs, such as for fast-food chains and pornography shops, not about the amount of IRB use," Mr. Salmon said. "If the projects Baltimore plans to finance with them are appropriate, that's OK."

(Congressional critics have questioned loopholes in federal tax law that permit IRBs, originally created to help "publicly useful" projects, to benefit others whose public purpose is less than clear.)

At the same time, President Reagan recently announced that as part of his revised tax package, he would ask Treasury officials to consider several measures, including a possible limit on future IRB use, as part of an effort to increase federal tax revenues.

(The widespread use of IRBs has alarmed many critics because it creates such a heavy drain on federal tax revenues. If current trends continue, some experts predicted this summer, the national level of IRB use could rise from $8.4 billion in 1980 to $40 billion in 1986.)

While no announcements have been made on any of these possible cutbacks, members of the financial community—including bond brokers and investors in New York—have been worried about possible impact if they occur.

The principal reason for their concern, Mr. Salmon suggested, is the memory of a 1979 congressional moratorium on mortgage revenue bonds, which had been widely used to finance local home-buying projects. Just before it was imposed, many cities initiated a similar rush to authorize the tax-free bonds.

Economic development commentary, v. 5, July 1981: 3-6

INDUSTRIAL REVENUE BONDS
A Cost-Benefit Assessment

By Robert E. Patterson

Recent adverse publicity notwithstanding, industrial revenue bonds can be the most powerful economic development incentive available to state and local governments. Yet a few sensational IRB abuses threaten to destroy the entire program. If state and local officials do not soon determine the appropriate use of IRBs, Congress will almost certainly act to restrict this important development tool.

Industrial revenue bonds have been subjected to a lot of harsh criticism lately. Stories are told and retold about how IRBs finance fast food chains, regional shopping malls, even topless bars. Newspapers cite billions of dollars in federal tax revenues lost because of IRBs.

The media have paid little attention, however, to the critical role of IRBs in the growth of smaller companies and the redevelopment of many urban areas. This role has been especially important during the past two years of the highest and most volatile interest rates in the nation's history. By cushioning the inflation-induced shock of escalating interest rates on expanding smaller companies and real estate developments, IRBs have enabled these projects to go forward.

Yet, because recent publicity has focused on foregone federal tax revenues and the few sensational uses of IRBs for controversial commercial developments, Congress is now searching for ways to control IRBs. The House Ways and Means Subcommittee on Oversight asked the Congressional Budget Office to prepare a report on IRBs, which was issued last April. The Subcommittee held hearings only two weeks later and has been considering a number of measures to limit the IRB program.

Much of the controversy surrounding industrial revenue bonds reflects their increased use for commercial developments such as suburban shopping malls. In Massachusetts, commercial properties receive IRB assistance only if they will contribute to the revitalization of distressed downtown areas. Above, this 144-year-old police station in Lowell is being converted into 35,000 square feet of commercial and office space with the help of a $1.5 million IRB.

But before draconian restrictions are enacted, the IRB debate should be put in perspective. There is more to this issue than has been reported in articles with such catchy titles as "The Burger Bond" and "Topless and Tax Free."

Increasing IRB Volume

An IRB is a tax-exempt bond issued by a state, county or local governmental authority to help private employers invest in fixed assets such as plant and equipment. Current federal law requires that the bond's proceeds be used for land or depreciable assets by a trade or business. Because of the bond's tax-exempt status, the lender, typically a bank, can lower the interest rate on the loan, usually to 60 to 75 percent of the prime lending rate.

No firm is eligible for IRB financing if its capital expenditures in the community exceed $10 million for three years before and three years following issuance of the bond. This capital expenditure limit—originally set at $5 million when it was adopted by Congress in 1968—was designed to focus IRBs on smaller companies and projects.

It is true that the volume of IRBs nationwide has risen sharply in recent years. The doubling of IRB volume in a single year—from $3.5 billion in 1978 to $7.1 billion in 1979—is not at all surprising, however. What is surprising is that the volume did not increase even more, given the fact that in 1978 Congress (a) doubled the capital expenditure limit for eligible companies from $5 million to $10 million and (b) granted a special $20 million limit for projects assisted with an Urban Development Action Grant.

Moreover, the increase in IRB volume must be considered against the inflationary pressures of recent years. The tremendous rise in interest rates,

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Robert Patterson is Executive Director of the Massachusetts Industrial Finance Agency.

TABLE 1
Revenue Gains Resulting From Elimination of Small Issue IRBs
(In Billions of Dollars)

Fiscal Year	Gross Revenue Gain[1]	Feedback[2]	Net Revenue Gain
1981	0.0	0.0	0.0
1982	0.3	0.1	0.2
1983	0.7	0.2	0.5
1984	1.1	0.5	0.6
1985	1.4	0.9	0.5
1986	1.8	1.1	0.7

Source: Congressional Budget Office, *Small Issue Industrial Revenue Bonds*, Washington, D.C., 1981.

[1] Effective July 1, 1981. Applies only to new issues after that date.

[2] Feedback = Federal revenue loss caused by decreased investment as a result of elimination of IRBs.

for example, has had its harshest effect on real estate developments and highly leveraged smaller companies, which naturally turned in desperation to IRBs to finance their growth.

Furthermore, inflation has vastly reduced the window of eligibility for IRBs. In fact, although Congress raised the capital expenditure limit from $5 million to $10 million, today $10 million will buy *less* plant and equipment than $5 million did in 1968. For example, the widely advertised 1980 IRB volume of $8.4 billion is equivalent to only $3.7 billion in constant 1968 dollars!

In large measure it is inflation, not overzealous state and local development officials, that is responsible for the nationwide increase in IRBs.

Cost of IRBs

Most newspaper accounts carried the Congressional Budget Office's projections of the cost of industrial revenue bonds to the federal government as $2.9 billion to $4.4 billion for FY 1986. Overlooked in the media, although clearly noted in the CBO report, was another projection: if *all* IRBs were eliminated on July 1, 1981, the net revenue gain to the federal Treasury would be only $.2 billion in 1982, rising slowly to $.7 billion in 1986 (see Table 1).

The CBO report also stated a number of other important, although often overlooked, facts:

- Despite fears that IRBs have substantially raised the cost of borrowing for state and local governments, in recent years the relative difference between tax-exempt and taxable interest rates has actually widened to 40 percent from the historic 30 percent.

In other words, tax-exempt interest rates have *not* risen as rapidly as taxable rates in spite of the inflation of recent years. It is hard to believe, therefore, that IRBs have had a serious negative effect on state and municipal borrowing, particularly since the projects financed by IRBs add to state and local tax revenues.

- IRBs are used overwhelmingly by smaller companies. The CBO reported that over 90 percent of all firms using IRBs in 1978 and 1979 were not listed on any national or regional stock exchange. These companies, therefore, depended on local lenders for their borrowed capital. For some 8,000 IRBs issued in those two years, the CBO noted that only 7 percent were for "Fortune 1000" firms.

In other words, the restriction adopted in 1968 to limit IRBs to smaller companies has done exactly that. In 1967, the average bond issue was $7.8 million, leading to the 1968 reform. In 1980, the average IRB was $1.3 million—one-sixth the size of the average 1967 bond, despite the doubling of prices during that period.

- By the CBO's own estimate, if the law governing IRBs does not change in the next five years, IRBs issued in 19[illegible] will create over $4 billion of additional Gross National Product (see Table 2). This increased GNP will include $2.2 billion in additional private wages and salaries—enough to employ 150,000 people at $15,000 a year.

If the 1986 cost of IRBs to the federal taxpayer, again by the CBO's estimates, is $700 million, then the CBO's numbers make IRBs the federal government's cheapest employment-producing program, at less than $5,000 per job.

Nor is the CBO report the only word on the cost of IRBs. A recent study by University of Chicago Business School economist Roger Kormendi, sponsored by the Massachusetts Industrial Finance Agency and the Small Business Foundation of America, concluded that the CBO's revenue loss estimates are six times greater than the actual loss to the federal government.

Kormendi based his conclusions and his testimony before the Oversight Subcommittee on assumptions about the behavior of lenders that seem more realistic than those used by the CBO. Both the Treasury and CBO assume that if IRBs were eliminated, lenders would replace tax-exempt IRBs with taxable loans. But Kormendi reasoned that lenders would not substitute taxable income for tax-exempt income because the combination of inflation and high taxes would destroy their capital.

For example, a lender in the 50-percent tax bracket who earned 15-percent interest in 1980 paid half that interest to the federal government, for a net return (ignoring state and local taxes) of 7.5 percent. Since inflation in 1980 was 12.8 percent, however, the lender actually lost 5.3 percent of his capital.

To at least keep even with inflation, Kormendi noted, investors would continue to put their funds into investments that are taxed at lower marginal tax rates—equity, real estate or "collectables," for example—rather than into investments yielding taxable income. In reality, therefore, the Treasury loses little revenue when IRB volume increases since most IRB investors are drawn from alternate investments on which they would pay little or no income tax in any event.

In addition, if IRBs were eliminated and borrowers forced to pay higher interest rates, then borrowers would have increased deductions for these higher interest costs. Thus, the federal government would be gaining more revenue because of increased taxes on lenders while simultaneously losing revenue because of increased deductions for borrowers' higher interest costs. Even the CBO admitted that such an effect is real but declined to estimate its impact.

The net effect of these adjustments, according to Kormendi, is a gross loss to the federal Treasury of about one-sixth the magnitude estimated by the CBO. When the CBO's own estimates of increased federal revenues from private investment stimulated by IRBs are added to Kormendi's estimates, the IRB program may actually produce revenue *gains* for the Treasury.

Although this result might seem surprising, it is hardly an outrageous idea. The same conclusion was reached in a 1980 study of IRBs by Dr. Norman Ture, then a private consultant and currently Undersecretary of the Treasury for Tax Policy.

The Controversy

If the cost to the federal government is not the issue, what then is all the fuss about? The controversy reflects an aura of widespread abuse combined with the

TABLE 2
IRB-Generated Increases in Investment, GNP, Income and Federal Revenue
(In Billions of Dollars)

			Taxable Incomes			
Year[1]	Investment	GNP	Wages and Salaries	Nonwage Income	Corporate Profits	Federal Revenues[2]
1981	0.02	0.03	0.02	0.00	0.00	0.00
1982	0.23	0.38	0.19	0.07	0.04	0.06
1983	0.69	1.21	0.62	0.23	0.11	0.23
1984	1.24	2.36	1.21	0.43	0.22	0.50
1985	1.75	3.61	1.84	0.65	0.34	0.84
1986	1.78	4.28	2.20	0.77	0.40	1.12

Source: Congressional Budget Office, *Small Issue Industrial Revenue Bonds*, Washington, D.C., 1981.

[1] Calendar years.

[2] Fiscal years.

long-standing opposition of some Congressional and Treasury staff to tax-exempt bonds generally. Recent efforts to stamp out the tax-exemption have included the taxable bond option for all state and municipal bonds, and last year, the successful attempt to nearly eliminate mortgage revenue bonds for single-family housing.

This year's attack on industrial revenue bonds has been aided by ample publicity of a few sensational projects, such as a country club, one go-go bar and a few national retail chains such as McDonald's and K-Mart. Indeed, it is the lack of a true consensus on the appropriate use of industrial revenue bonds that has given the opponents of tax-exempt bonds the opportunity to build a full head of steam which threatens to restrict or eliminate IRBs.

State and local development officials are often at odds over the appropriate use of IRBs. Most share a general view that small issue industrial revenue bonds should be used by smaller *industrial* enterprises financing plant and equipment to add jobs and increase employee efficiency. While the CBO report indicates that most IRBs, even in recent years, have in fact been used for this type of project, it also points out that there has been a recent increase in IRBs for *commercial* real estate development projects. It is these commercial projects that are creating the trouble.

In many localities, IRBs are being used to finance regional shopping malls and other suburban real estate projects that pose difficult choices for established downtown merchants. Either they can remain downtown while retail traffic is being drawn to the new mall by a powerful anchor store (to whom the developer has in some cases literally given away the store), or they can follow their customers to the mall and pay dramatically increased rents. In most cases, merchants cannot stop these malls on the basis of zoning or other land use control laws, so the IRB provides a focus for attacking the mall.

In Massachusetts and many other states, this type of real estate development is not eligible for IRB assistance. Commercial properties in Massachusetts receive such assistance only if they will contribute to the revitalization of a distressed commercial center. Focusing commercial IRBs on city and town centers has become a very important link in the state's expressed policy of reviving its downtowns. Massachusetts adopted this Commercial Area Revitalization District program for commercial IRBs because the executive and legislative branches recognized in 1978 that such a use of IRBs would reinforce an important public purpose for the state.

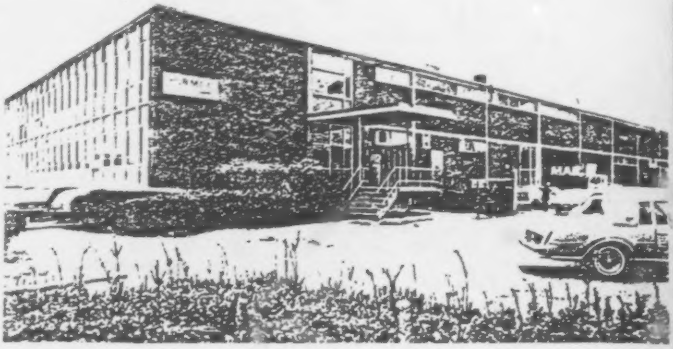
The public purpose for which IRBs of all types are issued is at the heart of the IRB controversy. State and local officials concerned with economic development, particularly urban development, simply must become more involved in determining the appropriate public purpose of IRBs, especially for commercial projects.

When one considers that the $8.4 billion of IRBs issued in 1980 is exactly *twice* the FY82 proposed Community Development Block Grant appropriation (including the UDAG program), it becomes obvious that IRBs are too critical an incentive to be taken for granted. Appropriately targeted, IRBs can be a state's most powerful and flexible tool. Left untargeted, commercial IRBs threaten to destroy the entire program.

Possible Restrictions

Without appropriate targeting, sooner or later the opponents of tax-exempt financing will succeed. Congress will eventually force states to target or will impose its own restrictions. No one federal definition of "distress" will satisfy everyone, but federally imposed limits are inevitable unless states prove themselves willing to tighten their public purpose requirements.

Particularly dangerous is the proposal to force states to better articulate public purpose by placing a dollar limitation on the IRBs a state can issue in a given year. This proposal has broad appeal at the federal level because it is simple, it sidesteps difficult choices, and it was recently used to nearly eliminate mort-



The crucial role of IRBs in financing the growth of smaller companies is often overlooked. The Hub Mail Company, which employed some 200 workers in an old multi-story building in downtown Boston, lacked the financing to purchase a more efficient facility in the distressed Columbia Point area of the city. With an IRB loan and a loan guarantee from the Massachusetts Industrial Finance Agency, Hub Mail was able to purchase the facility and hire 45 additional employees.

gage revenue bonds. Despite its simplicity, however, this type of restriction could be devastating.

For example, limiting IRBs to $50 per capita in each state would favor states with growing populations. Some 16 states would be forced to reduce their 1980 levels of IRBs; the 10 states that stand to lose the most are listed in Table 3. If such a restriction were enacted, firms that were unable to obtain IRB financing because a state had reached its limit could turn to another state for low-interest financing. Frostbelt states, which issued two-thirds of all IRBs in 1979 and which are already suffering from loss of industry and population, could ill afford such a disincentive.

In addition to accelerating the movement of business away from distressed areas of the country, a state cap on IRBs would pit big business against small business, and suburban areas against urban areas against rural areas. Many states would need special legislation merely to continue issuing IRBs, and the political pressures would be a nightmare.

Before Congress adopts a state cap or any other major limitation, it should carefully examine the likely consequences of such actions. It is hard to understand the rush to limit IRBs when an analysis of the CBO's position shows that eliminating *all* commercial IRBs would save only $40 million to $50 million in FY82—hardly a significant amount in a budget of $695 billion.

The Massachusetts Experience

In Massachusetts, IRBs have helped smaller companies to own their own plants. The bonds have provided a way for small firms to finance these facilities on reasonable terms at a time when thrift institutions have been pushed out of the market and commercial banks have moved to floating rates and shorter maturities. Unlike larger corporations and developers, smaller companies generally do not have easy access to the country's large institutional long-term lenders.

The Massachusetts Industrial Finance Agency (MIFA), an independent state agency that administers IRBs for the Commonwealth of Massachusetts and provides loan guarantees for small companies, has assisted more than 600 firms in its first two years of operation. Over half these companies had annual sales under $5 million, and three-fourths had sales under $20 million.

The Hub Mail Company is typical of the many firms that have indicated how essential MIFA's financial assistance was to their expansion. A direct mail service company, Hub employed some 200 workers, earning an average of $7 per hour, in an old multi-story building in downtown Boston. When its lease expired two years ago, the company wanted to purchase more efficient space in the city close to its labor supply. After an extensive search, Hub Mail settled on two vacant buildings in Columbia Point, a particularly distressed area of the city.

In his testimony to the Oversight Committee, Hub Mail President Walter S. Bernheimer II described the plight of his company: "Unfortunately, Hub Mail, like many smaller companies, was undercapitalized. We lacked sufficient internal funds to finance the expansion. As inflation drove interest rates higher and higher (and this was only the spring of 1979), and since we could only put down a modest down payment, all the lenders we approached declined to finance the acquisition of the Columbia Point facility with a conventional long-term mortgage."

The IRB loan and a loan guarantee from MIFA enabled Hub Mail to hire 45 additional employees in a depressed urban setting that is accessible to public transportation. According to Bernheimer, "It is not at all an understatement to say that none of this would have happened without industrial revenue bonds."

Summary

The country clearly needs a larger dose of savings and investment in productive assets. Although the causes of our national economic condition are complex, it is not difficult to understand why Americans are spending rather than saving their money. Their response to inflation has been completely rational, spending on goods for consumption and favoring investments that are untaxed or taxed at low marginal rates. When people believe they can achieve an after-tax rate of return on their money that is likely to exceed inflation, they will return to saving and investing in the future of this country's productive enterprises. IRBs and the tax-exempt market generally have provided investors an opportunity to invest and hope to stay even with inflation.

Given the importance of IRBs to economic development, the CBO's prognosis should be carefully considered before the program is severely restricted:

"If the Congress eliminated tax exemption on all small issue IRBs, some investments might not go forward. Others might move ahead, but changes in the amount and timing of investment would result. Smaller firms would be the ones most affected. Moreover, investment in distressed urban areas might decline because of the large number of UDAG projects that also receive IRB financing."

Is this a result that we can afford?

TABLE 3
Effects of $50 Per Capita IRB State Cap
States That Would Lose the Most

State	1980 Population	IRBs Issued 1980	IRBs Per Capita 1980	IRB Issues Under $50 Per Capita State Cap	Loss Compared With 1980 IRBs	Percentage Loss
		In Millions of Dollars				
Pennsylvania	11,866,700	$1,639.1	$138.1	$593.3	$ −1,045.8	64%
Minnesota	4,077,100	396.0	97.1	203.9	−192.1	49
Mississippi	2,520,600	239.3	94.9	126.0	−113.3	47
Oklahoma	3,025,300	276.3	91.3	151.3	−125.0	45
Wyoming	470,800	37.2	79.0	23.5	−13.7	37
New Jersey	7,364,200	578.0	78.5	368.2	−209.8	36
Indiana	5,490,200	386.1	70.3	274.5	−111.6	29
Ohio	10,797,400	724.2	67.0	539.9	−184.3	25
Rhode Island	947,200	63.1	66.6	47.4	−15.7	25
Massachusetts	5,737,000	369.2	64.4	286.9	−82.3	22

Source: Population data from U.S. Bureau of the Census, *Census of Population: 1980*, all other data from Congressional Budget Office.

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October 13, 1981

Honorable Henry J. Nowak
Chairman, Subcommittee on Tax,
Access to Equity Capital and
Business Opportunities
House Committee on Small Business
B363 Rayburn House Office Building
Washington, D. C. 20515

Dear Chairman Nowak:

Our firm has had considerable experience with industrial development bonds and is developing a short memorandum regarding the impact of Revenue Ruling 81-216. The memorandum should be completed within the next week and I respectfully request permission to have it included in your October 14, 1981 hearings.

For your information a short summary of the memorandum is attached.

Sincerely,

Dennis J. Taylor

DJT/ecu

SUMMARY OF CUMMINGS & LOCKWOOD TESTIMONY TO HOUSE SMALL BUSINESS TAX SUBCOMMITTEE

The small-issue industrial revenue bond program administered in the State of Connecticut by the Connecticut Development Authority has been an effective vehicle for the stimulation of business expansion in the State of Connecticut. The program has been well-managed and has been limited to industrial and commercial projects designed to increase employment within the State.

With the prime rate hovering near 20%, the CDA industrial revenue bond program is the only viable option for expanding their operations. To abolish the small-issue industrial revenue bond program at this time would be particularly disastrous to these businesses and would be at cross-purposes with recent Federal and State initiatives to foster small business expansion and growth.

The Connecticut industrial revenue bond program has been combined with other tax incentives offered by the State to encourage businesses to expand in the State's high-unemployment urban centers. To eliminate an important facet of this targeted incentive program would impede the expansion of businesses in these areas.

Revenue Ruling 81-216 should be reversed by Congressional action because it has had the effect in Connecticut of foreclosing the smallest businesses in the State - and those most in need of the relief afforded by tax-exempt interest rates - from the industrial revenue bond market.

If there have been abuses in the administration of small-issue industrial revenue bond programs in other states, reforms should be carefully considered. However, it would adversely affect small businesses throughout the State of Connecticut and would discourage business expansion at a time when reindustrialization and revitalization of the industrial sector is of paramount importance not only to the State of Connecticut and other Northeastern industrial states but to our entire economy.

Prepared Statement of Cummings & Lockwood, Attorneys at Law, Washington, D.C.

Our firm, with 5 offices in the State of Connecticut, has participated in a number of financing transactions involving small issue industrial revenue bonds issued by the Connecticut Development Authority (the "CDA"). We have represented borrowers who have used CDA-issued bonds to finance the expansion or relocation of their businesses to the State of Connecticut. We also serve as counsel to financial institutions which are frequent purchasers of the CDA-sponsored small issue industrial revenue bonds and which frequently serve as trustees in connection with such financings.

The CDA sponsors two distinct programs within the State of Connecticut. Its self-sustaining program provides financing of up to 100% of the cost of specific industrial, recreational and utility projects. The only limits in the amount being financed are those imposed by § 103 of the Internal Revenue Code. Under the self-sustaining program, each financing is separately negotiated, with the term of the issue, interest rates and other significant features the subject of negotiation between the borrower and bond-purchasers. Under the CDA's umbrella program, the loans are bonded by the State of Connecticut through its Industrial Mortgage Fund. Designed to provide access to the credit market for smaller businesses, the maximum amount of a financing under the CDA's umbrella program is $850,000.

Our experience has been that the self-sustaining and umbrella programs have been well managed and that officials within the State of Connecticut take very seriously their legislatively prescribed mandate to provide financial assistance "to industrial and commercial enterprises to remain or locate" in the State of Connecticut. Applications for participation in both programs are closely scrutinized, site visits are paid to projects for which financing is sought and a serious effort is made to ensure that all projects being financed adhere to the guidelines promulgated by the CDA.

Based upon our experience with the self-sustaining and umbrella programs, we believe that small issue industrial revenue bonds have been an effective vehicle for the attraction of new business to the State of Connecticut and for financing the expansion of businesses already located within the State. Officials from the State of Connecticut have estimated that over the past 3 to 5 years, approximately 10%

of the growth in the State's economy has been attributable to the availability of funding through the CDA's self-sustaining and umbrella programs. We have worked closely with boards of directors and officers of corporations who have considered relocating or expanding their facilities, and would agree that the availability of tax exempt financing is an important - oftentimes paramount - consideration in their decision-making process.

For many small and medium-sized businesses located in Connecticut or desirous of relocating to the State, the CDA's self-sustaining and umbrella bond programs provide the only viable financing vehicle for the expansion of their operations. With conventional interest rates in excess of 20% per annum, businessmen are reluctant to move into more modern, more efficient facilities because of the debt burden which they would be required to carry by virtue of such a move. Similarly, they are hesitant to make capital expenditures to create new job opportunities if such expansion must be financed by capital borrowed at rates in excess of 20% per annum. To abolish or severely restrict the small issue industrial revenue bond program at this time would be particularly disastrous to these businesses and would serve to undermine recent Federal and State initiatives designed to foster small business expansion and growth.

The recent pronouncement by the Internal Revenue Service in Revenue Ruling 81-216 has had a particularly profound effect upon small businesses within the State of Connecticut. As a result of Rev. Rul. 81-216, the CDA has been forced to impose a moratorium upon the acceptance of applications for its umbrella program. That program had been targeted to the smaller businesses in the State -- those with less access to traditional credit sources and most adversely affected by the current credit crunch.

The Department of Treasury should be encouraged to delay the effectiveness of Rev. Rul. 81-216 until the comprehensive reexamination of small issue industrial revenue bonds by Congress and the Executive Branch currently underway has been completed. If administrative relief is not granted by the Department of Treasury, the Congress should act to adopt legislation to delay the effectiveness of Rev. Rul. 81-216.

A reexamination of the small issue industrial revenue bond program can and should be conducted with the recognition that this program has been an effective stimulant for business expansion. It has enabled businesses to expand their operations and to relocate in our high-unemployment urban centers. With this in mind, the Congress should explore whether the small issue industrial revenue bond program can be made more effective or whether it can be targeted more effectively to small and medium-sized businesses.

If there have been abuses in the administration of small issue industrial revenue bond programs in other states, reforms should be carefully considered. However, elimination of the entire program or severe cutbacks in the program would be inappropriate. Such action would adversely affect small businesses throughout the State of Connecticut and would discourage business expansion at a time when reindustrialization and revitalization of the industrial sector is of paramount importance not only to the State of Connecticut and other Northeastern industrial states but to our national economy.

Thank you for providing us with an opportunity to make a statement to the Committee.

EMPLOYER RESPONSES TO SKILL SHORTAGES: IMPLICATIONS FOR SMALL BUSINESS

Patricia Flynn Pannell, Bentley College

Even in periods of high unemployment, skill scarcities are a fact of life. Shifts in business turnover and technological change create a continuing stream of skill demands. Skill scarcities of small firms are intensified by the tendency of large businesses to recruit workers from the small business sector and by the lack of strong relationships with local educational and training institutions.

This paper looks at how employers adjust to meet their manpower needs in light of changing labor market conditions. The first section of this paper describes several examples of recent and anticipated labor market imbalances. This is followed by a review of employer responses as seen through changes in starting salaries, recruiting patterns, job requirements and education and training programs. Thereafter is an analysis of hiring and employment practices of various size employers and the mobility of workers between firms of different sizes.

LABOR MARKET IMBALANCES

Labor market projections for the 1980's show a continued growth in demand for professional, managerial, technical and other white collar workers. Particular occupations, however, show distinctly different patterns of labor market imbalances. The following occupational categories illustrate these different patterns.[1]

Engineers

Historically, the supply of college-trained engineers has fluctuated widely as students adjust to changing labor market conditions. For instance, the number of engineering degrees conferred during the 1960's rose by 33%, while the number declined in the 1970's under the influence of deteriorating employment conditions in the late 1960's and early

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[1] This section on labor market imbalances draws heavily upon P.B. Doeringer, P.F. Pannell and P. Tandon, "Economic Trends in New England Since World War II: A Perspective for Higher Education in the 1980's," prepared for the New England Board of Higher Education's Commission on Higher Education and the Economy of New England, December, 1980.

Proceedings of the Small Business Research
Conference, forthcoming: Bentley College, Waltham, MA
March 5-7, 1981

1970's.[2] While enrollments were declining, however, the demand for engineers rebounded. The net result is today's shortage of engineers.

Although declining college enrollments are anticipated throughout the 1980's, engineering programs are now expanding as students respond to the improved job and salary conditions. In fact, the supply of engineering degrees conferred annually is projected to rise almost 50% by 1985.[3] Shortages are expected to shrink but will still be felt well into the mid-1980's as employment needs continue to expand.[4]

Computer Specialists

The market for computer specialists has been very strong throughout the 1960's and 1970's. Employment is expected to continue to grow well above average.

Unlike the supply of new engineering degree recipients, the number of computer and informations systems degree recipients have been steadily climbing in the past two decades.[5] However, while the rates of supply increase have more than kept pace with demand increases, the supply of computer specialists continues to fall short of labor market needs.

As would be expected, labor market shortfalls are being met more rapidly in those computer jobs requiring relatively less skill, while adjustments in more highly-skilled areas are taking longer to complete. For example, the market for keypunchers and console operators is already becoming saturated, while the labor market for computer programmers is not expected to come into balance until the mid-1980's. The demand for systems analysts far surpasses the supply of qualified workers and, if current trends continue, it is expected that these needs will not all be met by 1985.

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[2] National Center for Educational Statistics, Projections of Educational Statistics to 1986-87, (Washington, D.C.: Government Printing Office, 1978), pp 42-48; Neal R. Peirce, The New England States, (New York: W.W. Norton and Co., Inc. 1976); and R. Freeman, The Market for College-Trained Manpower, (Cambridge: Harvard University Press, 1971).

[3] National Center for Educational Statistics, op cit., pp 42-48.

[4] Massachusetts High Technology Council, Inc. Results of Survey on Human Resource Needs, (Boston: Coopers and Lybrand, 1980); U.S. Department of Labor, Bureau of Labor Statistics, Occupational Projections and Training Data (Washington, D.C.: U.S. Government Printing Office, 1979).

[5] National Center for Educational Statistics, op cit.

Business and Management Occupations

Employment in managerial and administrative positions rose about average from 1960 to 1970 while growth is projected to be slightly higher than average through 1985.[6] The supply of business and management graduates expanded throughout the 1960's and 1970's. The output of bachelor degrees in business and management is projected to peak in 1983-84 then drop slowly while post-baccalaureate degree recipients in these areas are projected to continue growing relatively fast throughout the mid-1980's.[7]

From now until 1985, the estimated number of business and management graduates each year falls far short of projected openings. However, for such positions as management trainees, many recruiters regard a wide variety of college majors (i.e. finance, accounting, business, economics, statistics, liberal arts) as substitute preparation for employment. As such, it is particularly difficult to identify the relevant available supply for these job openings and thus accurately predict shortages and surpluses.

There is a current debate over whether the market for MBA's will soon reach a saturation point.[8] Given the existence of about a 50% pay premium for new MBA's compared to bachelor degree holders in business and related fields in 1979-80, recruiters may shift more of their demands toward the less-expensive bachelor degree holders.[9] In light of the much slower growth and projected decline in the number of annual degree recipients at this level, these business-related undergraduates are likely to be entering a much stronger market.

Accountants

The demand for accountants has been quite strong since 1960, and projections indicate future demand will be slightly above average.[10] This favorable job market has enticed students to enter this field resulting in a three-fold increase of bachelor degree recipients and a six-fold increase in master degree recipients from 1960-61 to 1975-76.[11] Annual job openings for accountants, however, still exceed the annual number of degrees awarded. If education and employment trends continue, by the mid-1980's this gap should close. However, if as appears to be the case, recruiters are seeking 4-year college degree graduates for a growing number of accounting jobs, the market for these graduates will remain strong.

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[7] National Center for Education Statistics, op cit, pp. 42-48.

[8] B. Wysocki, Jr., "More Firms Avoid Hiring M.B.A.'s Due to High Pay, Other Problems," The Wall Street Journal, September 12, 1980.

[9] College Placement Council, Inc., A Study of Beginning Offers, (Bethlehem, PA: College Placement Council, Inc., 1980). See Section II of this paper for further salary data.

[10] U.S. Department of Labor, Bureau of Labor Statistics, op cit; L. Lecht, op cit.

[11] National Center for Educational Statistics, op cit, pp. 42-48

Machining Occupations

As the economy shifts away from goods-producing toward a more service orientation, craft occupations in general will comprise a smaller and smaller share of the total employment. Machining occupations, in particular, are expected to grow well below average through 1985.[12]

However, due to the fact that the age distribution of workers in these occupations is skewed toward older workers, many of whom entered their jobs in the 1930's, replacement needs are expected to remain strong for the next few years.[13]

Whereas machine tool operators are usually entry-level positions for individuals who can read blueprints and have some mechanical ability, all-round machinists and tool and die makers generally require several years additional learning on the job. Many employers prefer that this training occur as part of an apprenticeship program which would ensure broad and systematic skill development. Formal apprenticeships meet only a fraction of the total demand as do school-based programs. As a result, the projected supply of occupationally trained graduates and apprentices in these fields fall short of the anticipated demand for these workers through the mid-1980's.

Secretaries

Secretarial jobs have been growing much faster than average since 1960, and this trend is expected to continue through 1985. The supply of qualified workers for these jobs is not keeping pace with rising demand. In fact, while a 20% (88,000) shortage of secretaries was estimated by the Department of Labor in 1978, projections show a vast worsening of the mismatch with the shortfall in excess of 700,000 by 1985.[14]

Unlike the previously described occupational shortages, part of the secretarial shortage is due to the fact that with the growing array of employment alternatives available to women, many are now passing over the relatively low-paid, traditionally female jobs which generally lack advancement opportunities.

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[12] U.S. Department of Labor, Bureau of Labor Statistics, op cit.

[13] Ibid.

[14] T.J. Murray, "The Big Hunt for Secretaries," Dun's Review, (May 1978), pp. 88-90; U.S. Department of Labor, Bureau of Labor Statistics, op cit.

Given the relatively low entry requirements for this occupation, the question is raised as to whether the shortage is actually one of "quantity" or one of "quality." Amid widespread complaints of educational deficiencies of high school and college graduates, employers have noted poor spelling and grammer, in particular, have negatively impacted secretarial quality.[15]

EMPLOYER RESPONSE: WAGE AND NON-WAGE ADJUSTMENTS

Starting Salaries

One way employers can attract skilled workers who are in relatively short supply is to raise wages. This not only affects the allocation of such workers in the short run but also affects educational enrollment patterns as students respond to changes in relative salaries.

Data on national salary offers made to bachelor degree recipients between 1973-74 and 1979-80 shows that engineering and computer science graduates were offered relatively high salaries throughout the period.[16] (See Table 1) Starting offers for graduates with accounting degrees remained above those for graduates in the social sciences, humanities, and business fields; however, they rose more slowly.

There was much less variation in starting salaries and recent salary increases for masters degree candidates. (See Table 2) MBA's commanded high salary premiums over graduates with bachelors degrees in business administration.

These salary data indicate that, at least in the market for the college-educated, pay and enrollment adjustments are working as expected in response to changing patterns of demand. The overall occupational education network for non-college graduates has also been shown in the literature to be responsive, albeit with lags, to labor market

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[15] Massachusetts Department of Manpower Development, Massachusetts Division of Employment Security, Massachusetts Occupational Information Coordinating Committee, An Analysis of Selected High Net Demand Occupations: Findings From a State-Wide Survey. (Boston, 1980). C. Hymowitz, "Employers Take Over Where Schools Failed to Teach the Basics," The Wall Street Journal, (January 22, 1981), p. 1.

[16] College Placement Council, Inc., op cit.

TABLE 1

National Average Monthly Salary Offers

Bachelor Degree Candidates, 1973-74 to 1979-80

Curriculum	Average Dollar Offers		Percent Change		
	1973-74	1979-80	1973-74 to 1979-80	1973-74 to 1976-77	1977-78 to 1979-80
Business					
Accounting	$ 925	$1293	+ 39.8%	+ 14.8%	+ 15.0%
Business - General (Including Management)	803	1218	51.7	15.4	22.7
Marketing & Distribution	769	1145	48.9	16.5	19.3
Humanities & Social Sciences					
Humanities	691	1074	55.4	17.2	23.3
Economics	-	1252	-	-	22.9
Social Sciences	737	1072	45.5	17.1	20.0
Engineering					
Engineering - Aeronautical	961	1648	71.5	27.6	21.7
Engineering - Chemical	1042	1801	72.8	33.3	19.0
Engineering - Civil	967	1554	60.7	22.5	20.7
Engineering - Electrical	986	1690	71.4	26.3	23.6
Engineering - Industrial	979	1655	69.1	28.4	21.2
Engineering - Mechanical	1001	1703	70.1	28.5	21.3
Engineering - Metallurgical	1004	1726	71.9	31.0	21.7
Engineering - Mining	-	1734	-	-	15.8
Engineering - Nuclear	-	1668	-	-	22.6
Engineering - Petroleum	-	1987	-	-	20.2
Engineering - Technology	934	1585	69.7	26.0	23.0
Sciences					
Agricultural Sciences	785	1192	51.8	17.8	23.5
Biological Sciences	720	1159	61.0	22.5	11.9
Chemistry	884	1459	65.0	24.7	22.5
Computer Science	915	1558	70.3	22.7	23.1
Health (Medical) Professions	733	1155	57.6	22.0	21.7
Mathematics	874	1475	68.8	22.8	24.5
Other Physical & Earth Sciences	895	1543	72.4	19.3	24.5

Source: College Placement Council, Inc., A Study of Beginning Offers, (Copyright © by the College Placement Council, Inc., Bethlehem, PA, all rights reserved.)

TABLE 2

National Average Monthly Salary Offers to Inexperienced[a]

Masters Degree Candidates, 1973-74 to 1979-80

Graduate Program	Average Dollar Offers		Percent Change		
	1973-74	1979-80	1973-74 to 1979-80	1973-74 to 1976-77	1977-78 to 1979-80
Business Administrative-Industrial Management or Commerce[b]					
After Non-Technical Undergraduate	$1181	$1795	+ 52.0%	+ 19.4%	+ 19.8%
After Technical Undergraduate Degree	1235	1971	59.6	21.7	21.7
Accounting	-	1873	-	-	13.9
Humanities & Social Sciences					
Humanities	855	1309	53.1	17.4	29.9
Social Science	917	1298	41.5	13.0	17.8
Engineering					
Chemical	1172	1947	66.1	28.8	19.5
Civil	1102	1753	59.1	21.8	19.8
Electrical	1149	1912	66.4	22.7	22.8
Industrial	1120	1861	66.2	26.2	22.4
Mechanical	1138	1893	66.3	26.4	20.5
Nuclear	-	1831	-	-	23.7
Physics	1089	-	-	-	-
Sciences					
Agriculture & Related Sciences	950	-	-	-	-
Chemistry	1050	1688	60.8	25.8	11.4
Computer Science	1120	1858	65.9	23.2	20.6
Mathematics	1042	1685	61.7	23.3	18.9
Metallurgy	1131	1891	67.2	24.2	21.0
Geology & Related Geological Sciences	-	1873	-	-	23.5

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[a] One year or less, full-time, non-military employment

[b] 1979-80 figures for MBA's only.

SOURCE: College Placement Council, Inc., A Study of Beginning Offers, (Copyright© by the College Placement Council, Inc., Bethlehem, PA, all rights reserved) conditions.[17] Such responsiveness was found to differ significantly by occupation and by type of training institution, as certain programs are strongly influenced by competition from other schools, funding sources, government regulation, physical plant and equipment investments, institutional goals and bureaucratic lags.[18]

Non-wage Adjustments

The above analysis suggests that market responses provide a self-adjusting mechanism for eliminating skill shortages and surpluses. However, where curricula mix has been relatively slow or insensitive to labor market conditions, employers have been found to adapt their hiring standards and job requirements to their estimates of available supplies and qualifications of graduates.[19] In fact, some companies that offer their own education programs have noted that they adjust their instruction manuals and revise courses in response to the level of preparation of incoming trainees.[20]

Recent estimates of the amount of formal education taking place in industry today are in the $40-60 billion a year range.[21] The main reasons given for such expenditures include not only that employers feel that the schools are unable to provide them with the quantity and quality of workers which they seek but also that many employers feel much more suited than the schools for providing training to meet the company's specific needs.

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[17] P. Pannell, "Training and Work: Educational Institutions in a Local Economy," Unpublished dissertation (Boston: Boston University, 1980); G. Somers, "The Response of Vocational Education to Labor Market Changes," Journal of Human Resources, (Supplement, 1968), pp. 32-58; G.L. Mangum, "Curriculum Response to Occupational Trends," in G.G. Somers and J.K. Little (eds.), Vocational Education: Today and Tomorrow, (Madison: Center for Studies in Vocational and Technical Education, University of Wisconsin, 1971).

[18] P. Pannell, "Do Schools Adjust to Changing Job Demands? The Worcester Experience," Thrust, The Journal for Employment and Training Professionals, (Winter-Spring, 1980), pp. 105-123.

[19] I. Berg, Education and Jobs: The Great Training Robbery, (New York: Praeger Publishers, 1970); J.K. Folger and C.B. Nam, Education of the American Population (Washington, D.C.: U.S. Government Printing Office, 1967).

[20] See for instance, W. Springer, "Education and Training Programs in the Bell System," in P. Doeringer (ed.), Workplace Perspectives on Education and Training, (Boston: Martinus Nijhoff Publishing) 1981, pp. 103-113.

[21] P. Doeringer, op cit.

Employers, in general, would like the schools to teach the basics (the 3 R's) and such general skills as blueprint reading and typing which are highly transferable between employers.[22] More specifically, employers want to hire workers (1) who already have basic English, computational and communication skills, (2) who are able to absorb specific types of training that employers will provide, and (3) who are motivated.

Several studies confirm that "attitude" of potential workers is probably the best indicator of subsequent employment success.[23] This attitude has been described as embodying alertness, interest, willingness, appearance and other "ascriptive" qualities. In fact, the question has been raised as to whether educational credentials are used by employers as a screening device, and proxy of motivation and trainability, rather than as an indication of skill development.[24]

Adjustments Through Schools

The dividing line between school and industry education and training is not distinct, and it also changes over time. For instance, in times of rapid technological change and emerging skill requirements employers must provide the training to meet their new needs. When employer demand for these skills is sufficiently large, private consulting firms and proprietary (private, for-profit) schools tend to "jump in" and offer new programs in these fields. Thereafter, other private schools and public schools begin to offer training in such areas.[25] This cycle occurred, for example, with key punching in the recent past and is now proceeding with word processor training.

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[22] M. Duggan, S. Hudson-Wilson, and B. Vermeulen, "Private Sector Employment Strategies: How Employers Hire and Train," and P. Pannell, "The U.S. System of Occupational Education and Training: Goals and Performance" in B. Vermeulen and P. Doeringer, (ed.), Jobs and Training: Vocational Policy and the Labor Market, (Boston: Martinus Nijhoff Publishing), 1981; Paul Osterman, Getting Started: The Youth Labor Market, (Cambridge: MIT Press, 1980).

[23] T. Grasso, Learning The Tool and Diemaker Trade, (Washington, D.C.: U.S. Government Printing Office, 1970); B.G. Reubens, "Vocational Education for All in High School?" in O'Toole (ed.), Work and the Quality of Life, (Cambridge: MIT Press, 1974), pp. 299-337; P. Osterman, "The Structure of the Labor Market for Young Men," in M. Piore, (ed.), Unemployment and Inflation, (New York: Sharpe Publishing Company, 1979); R.C. Edwards, "Individual Traits and Organizational Incentives: What Makes a Good Worker," Journal of Human Resources, (Winter, 1976), pp. 51-68.

[24] M.A. Spence, Market Signalling Informational Transfer in Hiring and Related Screening Processes, (Cambridge: Harvard University Press, 1974); P. Taubman and T. Wales, Higher Education and Earnings: College as an Investment and as a Screening Device (New York: McGraw-Hill Book Company, 1974); R.B. Freeman, The Over-Educated American, (New York: Academic Press, 1976); I. Berg, op cit.

[25] P. Pannell, "Training and Work," op cit.

As noted earlier, employers want to provide the training for some jobs, particularly in higher skill jobs. However, they encourage shifting the more general and entry-level training, along with its costs, to the schools.[26] While employers prefer not to provide remedial training, that is, basic English and mathematics courses, many firms now feel they have to, as they have found numerous graduates deficient in these areas.

Differences by Firm Size

While the preceding discussion about adjustments to labor market imbalances does not differentiate firms by size, the presence of training costs and on-the-job training as workers move up job ladders suggests that firm size is a critical factor in an employer's ability to train and retain workers.

Most studies on labor market imbalances and employer hiring patterns do not report findings by firm size.[27] One recent study, however, which surveyed over 600 firms nationally, did take firm size into account.[28] Unfortunately for those interested in "small" businesses this survey included only firms of 500 or more employees. However, this study does report some significant findings that shed light on the role of firm size in education and training in industry. In particular, the study found:

- Overall 75% of the companies surveyed offered in-house courses and 89% had tuition aid programs.

- Formal education and training activities were far less prevalent in smaller companies than large.

- Almost 90% of the companies with over 10,000 employees provided courses in management subjects and in functional areas while less than half of those companies with fewer than 500 employees did so.[29] (See Table 3)

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[26] P. Osterman, Getting Started, op cit; P. Doeringer and M. Piore, Internal Labor Markets and Manpower Analysis (Lexington: D.C. Heath Book Company, 1971).

[27] R. Wenig and W. Wolansky, Review and Synthesis of the Literature on Job Training in Industry, (Columbus: Center for Vocational and Technical Education, Ohio State University, 1972); D. Diamond and H. Bedrosian, Industry Hiring Requirements and the Employment of Disadvantaged Groups, (New York: New York University School of Commerce, 1970); Massachusetts Department of Manpower Development, op cit.

[28] S. Lusterman, Education in Industry, (New York: The Conference Board, Inc., 1977). Also see L. Branscomb and P. Gilmore, "Education in Private Industry," Daedalus, (Winter, 1975), pp. 227-233.

- Large companies spent much more money per employee on training ($72 per employee in the largest firm size category versus $19 in the smallest) and spent a much larger proportion of such expenditures on functional training than smaller firms. Smaller companies spent a relatively high percentage of their training budget on management training (see Table 4).

- The likelihood that newly hired employees participated in functional or management training programs increased as firm size increased.

- While not attributable to firm size, the extent of education in industry differed significantly by type of industry. Financial institutions and transportation, communications and utility companies were most likely to provide training while wholesale, retail and manufacturing firms fell way behind.

A study done in 1978 by the Bureau of National Affairs in general confirms these findings, although this study classified firms only as either greater or less than 1000 employees.[30] Some of the smaller employers who had no formal education or training programs indicated that they concentrated on recruiting and hiring already-trained employees for their higher skilled jobs; informal on-the-job training was prevalent in many of the lesser-skill level jobs.

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[29] The questionnaire used described categories as follows:
- Management Development and Supervisory Skills: i.e. principles of management, organizational development, sensitivity training, management by objectives, decision making, interpersonal skills, electronic data processing for management, equal employment opportunity, training of trainers.
- Functional and Technical Skills: i.e. production, maintenance, marketing, sales, service, office, administration, internal systems, finance, personnel. This category is intended to reflect all courses related to work skills and knowledge other than those specifically included in the managerial group.
- Basic remedial education: i.e. reading, writing, arithmetic.
- Other Subjects: Any not included in the categories mentioned above: i.e. economic education, foreign language, English as a second language.

[30] M.G. Miner, Training Programs and Tuition Aid Plans, (Washington, D.C.: Bureau of National Affairs, Inc., 1978).

TABLE 3

Percent of Companies Providing Courses, By Course Area and By Company Size

Course Area[a]	Number of Employees					
	10,000+	5000-9999	2500-4999	1000-2499	500 999	Total
Management-Supervisory	91%	88%	82%	67%	47%	60%
Functional-Technical	87	80	56	56	42	54
Basic Remedial	29	14	14	4	4	8
All Other	22	17	19	5	10	11

[a] For definitions, see footnote 29.

Source: S. Lusterman, Education in Industry, (New York: The Conference Board, 1977) p. 49.

TABLE 4

Distribution of Expenditures for Company Courses by Company Size

Course Area[a]	Number of Employees					
	10,000+	5000-9999	2500-4999	1000-2499	500-999	Total
Management Supervisory	17%	36%	46%	47%	43%	24%
Functional-Technical	81	62	50	51	51	74
Basic Remedial	1	1	2	1	3	1
All Other	1	1	2	1	3	1
Total Expenditures	100%	100%	100%	100%	100%	100%

[a] For definitions, see footnote 29.

Source: S. Lusterman, Education in Industry, (New York: The Conference Board, 1977) p. 49.

While there are no estimates on the extend of informal on-the-job training, surveys done by the Department of Labor suggest that this type of training is the single most important source of skill development.[31]

SMALL FIRMS VERSUS LARGE FIRMS: MORE EVIDENCE OF EMPLOYMENT PRACTICES

While large scale survey data on employment and training patterns are not available for businesses by firm size, scattered evidence from case studies as well as the recent literature on youth labor markets provide insights into the hiring and employment practices of various size employers and the mobility of workers between firms of different sizes.

For instance, with respect to recruiting patterns, while some small metalworking firms and machine shops have been found to compete with large plants by offering higher-than-prevailing wage rates, more often than not, smaller employers pay lower wages and attract workers by offering a different package of working conditions.[32] In general, smaller firms provide the opportunity for a much more informal and personal employment relationship than is possible given the more bureaucractic procedures of larger companies.[33]

Paternalism is often evidenced in smaller firms through practices such as making personal loans, giving advice to workers, bailing employees out of jail and sponsoring social events for employees and their families - practices found much less often in larger businesses. Smaller firms also provide benefits such as greater recognition by management and "psychic income" derived from the fact that "you can make a difference" in a small company.[34]

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[31] U.S. Department of Labor, Bureau of Labor Statistics, Occupational Projections and Training Data, (Washington, D.C.: U.S. Government Printing Office, 1976), p. 14; U.S. Department of Labor, Bureau of Labor Statistics, Occupational Training in Selected Metalworking Industries, (Washington, D.C.: U.S. Government Printing Office, 1974); G.G. Somers and M. Roomkin, "Developing Reliable Data on Training in Industry." Monthly Labor Review (February, 1974), pp. 33-37.

[32] J.H. Soltow, Origins of Small Business Metal Fabricators and Machinery Makers in New England, (Philadelphia: American Philosophical Society, 1965).

[33] G.W. Rimler and N.J. Humphreys, Small Business, Developing the Winning Management Team, (New York: American Management Association, 1980); W.L. Siegel, People Management for Small Business, (New York: John Wiley and Sons, Inc., 1978); R. Berghash, Investment in People: A Small Business Perspective, (New York: American Management Association, 1974).

In addition, several studies indicate that in viable small businesses, employers have provided relatively stable employment to their employees. For instance, a study of small metalworking firms in New England between 1890 and 1957 shows:

> [M]anagement usually adjusted to the business cycle by changing the length of the work week rather than by the size of the labor force... in a few cases, small enterprises prevented layoffs in slack periods by using production workers on maintenance jobs. A small machine shop with twenty-five workers actually expanded its plant during a recession in the late 1950's with operatives performing construction work.[35]

This policy of avoiding layoffs tends to inculcate in workers a sense of loyalty to the employer. In fact, stories of plant relocations often include examples of workers commuting very long distances or moving their residences in order to remain with their employer.[36] The behavior of both employers and employees in these small businesses contributed to a relatively low rate of employment turnover.

Avoiding layoffs in times of business slowdowns also minimizes the recruiting of new workers when business picks up. This practice is particularly important for small businesses given their limited recruitment budget compared to larger firms. On the other hand, small businesses are likely to feel the pinch of industry-wide occupational shortages more than large firms. In instances where larger companies have automated in order to eliminate part of their lower-skill labor demands, such equipment costs have been prohibitive to smaller firms.[37] In the face of shortages of higher-skill workers, smaller firms, unlike larger employers, cannot afford to initiate in-house training programs thereby transforming, over time their own low-skill, entry-level workers into a highly trained workforce.

This lack of formal internal training programs coupled with relatively short job ladders in small businesses, hinders workers mobility and promotion opportunities and poses a major problem for small businesses trying to retain good workers. As noted in a study of a small New England factory:

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[35] Ibid., p. 38

[36] Ibid., p. 39

[37] M. Daley and R. Fitzgerald, Labor Area Trends In Supply and Demand FY 1978-79, (Boston: Division of Employment Security, Department of Labor, 1979)

> On paper the organization chart looks like a simple promotional ladder, with workers at the bottom, foremen on the next step, assistants to managers on the next, and so on up. In practice this works only in exceptional cases...the worker who would start at the bottom and work up would be a remarkable exception. He might go as far as foreman but probably no further, even this modest rise is coming to require more than mere plant training and experience.[38]

Analyses of youth labor markets provide additional information on hiring practices of different size firms. For example, a subset of the first jobs non-college bound youth obtain after high school has been identified as making an important contribution to the careers of young workers.[39] These jobs tend to be found in small businesses and, while they are often relatively low-paid, they provide some on-the-job training and a personal, employment relationship under close supervision. As such, these jobs, for instance those often found in "Mom and Pop" stores, small construction companies, auto repair shops and small manufacturing firms, help to build positive work attitudes and skill development. In addition, these jobs, sometimes referred to as "bridge jobs", act as feeders to larger firms by providing workers with referrals for jobs on the larger firm's internal job ladder.

Large companies, in general, prefer to hire experienced workers, usually over 21 years of age, who have general skills and knowledge.[40] Employers then provide these workers with the specific skills needed for the job. The existence of relatively long job ladders and significant investments in training do not guarantee the large firms their requisite number of higher-skilled workers as these internal labor markets also generate an expanded pool of trained workers which smaller businesses can draw upon to meet their skill requirements.[41] As a study of consumer-product firms indicates:

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[38] J.S. Ellsworth, Jr., Factory Folkways: A Study of Institutional Structure and Change (New Haven: Yale University Press, 1952), pp. 151-2, as cited in Soltow, op cit, p. 198.

[39] Osterman, Getting Started, op cit.

[40] Osterman, Getting Started, op cit. pp. 28-29; D. Olszewski, Education, Training and Employment in Worcester, Parts I-IV, (Boston: Regional Institute on Employment Policy, Boston University, 1979); P.E. Barton and B.S. Fraser, Between Two Worlds: Youth Transition From School To Work, Vol. I, (Washington, D.C.: National Manpower Institute, 1978).

[41] Piore and Doeringer, op cit; Osterman, Getting Started, op cit; C. Brecher, Upgrading Blue Collar and Service Workers, (Baltimore: The John's Hopkins Press, 1972).

> The (large) companies spend several years orienting and training these employees (trainees) to find that many leave to join smaller firms that cannot afford such heavy training costs but are able to meet competitive salary levels once these specialists have had the benefit of several years of experience.[42]

Similar outflows of trained workers from large employers to small companies have also been noted in the Federal Government. Lawyers, economists and accountants have left government agencies for jobs with smaller employers, after having acquired "a good understanding of how the government deals with the problems in these specialized areas."[43]

Large companies also provide a major source of the enterpreneurs to small businesses. Studies show that many of the founders of small businesses preferred the more risky environment of a new venture to the large business bureaucracy and what they perceived as a reluctance on the part of supervisors to try new things.[44]

In sum, the likelihood of differing abilities to respond to labor scarcities and of patterns of worker flows between various size firms is intuitively obvious once one understands the markedly different work environments and employment practices of different size employers. These flows result from the employers' hiring practices and the presence of training costs and from the changing needs of individuals in their career development process. Small businesses often employ recent high school graduates and are forced to train them informally on the job. These firms then lose many of these workers to larger companies that are interested in hiring more mature, experienced workers whom they will then provide specific skills and opportunities for advancement. conversely, small firms must often recruit at high salaries, highly-skilled workers from large employers.

The extent of these labor market flows is unknown. In fact, economic conditions would alter the magnitude of such flows by directly influencing both the needs of employers as well as the willingness of workers to change jobs. The scenario above suggests that skill shortages can squeeze the small business at both ends as larger firms lower their hiring standards to get more workers into their training pipeline, and increase the compensation paid to their top personnel to retain those in high demand. While few would argue that money is the only determinant of labor mobility between employers, especially in the case of "entrepreneurial spirit," it seems likely that the flow of highly skilled workers from large to small firms is partly constrained by the ability of smaller firms to pay competitive salaries.

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[42] E. Ginzberg, "The Role of Small Business in The Process of Skill Acquisition," in S. Bruchey, (ed.) Small Business in American Life, (New York: Columbia University Press, 1980), pp. 376.

[43] Ibid., p. 376.

[44] J.H. Soltow, "Origins of Small Businesses and the Relationship Between Large and Small Firms: Metal Fabricating and Machinery Making in New England, 1890-1957," in S. Bruchey (ed.) op cit, p. 198.

Given the differences in working conditions in firms of different sizes, the personalized small business environment appears to be more conducive to developing good work habits and attitudes than are larger, more formalized employment relationships. In contrast, compared to larger businesses, smaller firms are likely to be much more dependent on the schools for skill development.

POLICY IMPLICATIONS FOR SMALL BUSINESSES

Several interesting policy implications for small businesses arise from the preceding analysis:

(1) As in other areas of management, the small business has relatively few resources to spend on human resource development. Yet human resource management in the small business is a critical factor if the firm is to meet its manpower requirements. The small business may wish to pay more attention to human resource development within the firm. For instance, small firms could try to internalize the training flows of workers now taking place between firms by reallocating funds used in recruiting high-paid, high-skilled workers from large firms to programs aimed at retaining their own semi-skilled employees. Job turnover could be reduced by paying higher salaries to mid-level employees and by establishing internal promotion paths. Not only would the perceived need of lower level workers to move "up and out" be curtailed, but also a considerable degree of employee loyalty would be generated.

(2) Small businesses can also benefit by improving their external relations with human resource development organizations such as the schools and government training programs. This is particularly true given the increased importance the recruiting function takes on when new employees are looked upon as long-term rather than short-term employees.

The small business often encounters difficulties in dealing with schools as it is easier from the school's perspective to maintain a relationship with one large employer than several small employers. Also the desires of small employers for individuals who are more broadly trained, who can take over as a "jack-of-all trades" and handle many facets of the business, poses greater training challenges for schools than would more narrow training.

(3) Small businesses and large businesses provide markedly different employment environments for both blue collar and white collar workers. Traditionally the schools have been oriented to the needs of large companies yet are often frustrated when these large employers fail to hire their graduates. The schools would thus find it advantageous to culti-

vate better relations with small businesses not only as a source of jobs but also as a good environment for the career development of young workers.

(4) Small businesses should distinguish different types of schools and their abilities to respond to the particular training needs of small employers. Small businesses regularly overlook the proprietary school for instance, as a source of labor supply. Reputable proprietary schools have often been found to precede the public schools in developing programs in areas of new and expanding local labor market demands. Their relatively fast, "no-frills" training approach could well complement the paternalistic small business work environment.

(5) Lastly, much of the "evidence" presented in this paper is derived from a relatively small number of case studies spanning decades as well as a variety of industries and occupations. More systematic study is needed, for instance by specific industry or geographic area, to see if these employment and hiring patterns and labor market flows between different size firms stand up under more rigorous scrutiny.

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TESTIMONY OF
PAUL L. PRYDE, JR.,
PRESIDENT OF JANUS ASSOCIATES
Before the
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
ON S. 1310, THE URBAN JOBS AND ENTERPRISE ZONE ACT

My name is PAUL L. PRYDE. I am President of JANUS ASSOCIATES, a consulting firm which specializes in local economic and enterprise development problems. Among other projects, our firm has recently completed a comprehensive revitalization plan for areas of Miami and Dade County damaged by the riots of May 1980. You will be pleased to know that our report recommended the creation of an enterprise zone in Dade County as a central job and business development strategy. In addition to our work in Miami, we have also spent a substantial amount of time over the past nine months advising economic development, public policy and urban interest groups on the enterprise zone concept. During the course of this work, we have developed several ideas which we believe can help make enterprise zones a workable reality.

I want to thank the Subcommittee for this opportunity to share some of them with you.

S. 1310, The Urban Jobs and Enterprise Zone Act is, in brief, a measure to use tax incentives to encourage business expansion and job creation in areas of poverty and high unemployment. In my testimony before you today, I want to examine two issues which will determine, in my judgment, whether the incentives offered in S. 1310 will have the desired effects on the revitalization of depressed areas. They are the following:

(1) The extent to which the tax incentives offered in S. 1310 represent a package of adequate financial benefits to firms and investors.

(2) The extent to which these incentives will be rendered more or less valuable by other anticipated changes in the tax code. The first of these questions I will discuss in some detail. The second requires only brief treatment.

The Extent to Which S. 1310's Blend of Tax Incentives Is Right

S. 1310 and H.R. 3824, its House companion, represent a substantial improvement over similar bills introduced last year. Now, rather than business tax cuts aimed principally at large corporations, both measures propose incentives designed to overcome the capital and labor market barriers which tend to retard the expansion and formation of new, small firms which create most new jobs. S. 1310 proposes two incentives designed to increase the supply and decrease the cost of labor:

- A refundable 5% tax credit against wages paid by employers in enterprise zones.
- A refundable 5% credit against taxes owed by employees in enterprise zones.

In addition, it proposes four incentives designed to enable eligible firms to attract outside financing and retain more of their internally generated cash for expansion:

- The elimination of capital gains taxes on enterprise zone investments for both corporations and individuals.
- A 50% taxable income exclusion for firms operating or lending in enterprise zones.
- An optional cash accounting method for businesses with up to $2 million in gross revenues.
- An extension of the net operating loss carry forward to 20 years.

Let me discuss each group of incentives in order.

Employment Incentives

- Refundable employer tax credit.

  This incentive is apparently aimed at offsetting the cost of employer payroll tax contributions and could be used, as I read the Bill, as a supplement to the Work Incentive and Targeted Jobs Tax credit now available. If this understanding is correct, the provision is an excellent one and should prove useful to enterprise zone employers. I would suggest only one improvement for the Subcommittee's consideration. To help conserve the cash of fledgling companies, enterprise zone firms should be allowed to reduce their regular tax payments by the amount of the estimated credits for which they are eligible. Under the current proposal, cash poor young companies would have to wait until year end to realize the credit's benefit. With the change I propose, they could achieve an immediate improvement in cash flow.

- Refundable 5% tax credit for employees.

In my judgment, this incentive is one which will be only marginally helpful in stimulating employment. There are two reasons for this view. First, there is little reason to believe that poor people refuse to work because their taxes are too high. A 5% credit against income taxes is unlikely to make someone who is otherwise uninterested in work excited by the prospects of employment in an enterprise zone. Second, the incentive appears to provide only a limited financial benefit. Someone with an adjusted gross income of $10,000 would get only about $50 in tax relief. Similarly the tax benefit for a worker earning $25,000 would amount to only about $200.

A small reduction in the already light tax burden of low income workers is not likely to change their employability or attitudes toward work. What is needed instead is a substantial incentive for jobless workers to train themselves for the employment opportunities which new zone firms will create. Thus, as an alternative to the 5% employee tax credit, I would recommend a $2,500 voucher or refundable tax credit which eligible job seekers could use to defer costs of training and education in connection with enterprise zone jobs.

Capital Investment Incentives

- Elimination of capital gains taxes on enterprise zone investments.

This proposal would reduce capital gains taxes on investments made in enterprise zones from the current 28% (20% if the current

Ways and Means proposal is adopted) to zero. Allowing investors to escape payment of such taxes is an obvious way to make enterprise zone investments competitive with similar investments elsewhere. Unfortunately in this case, appearances are deceiving. Let me explain. Let us assume that an investor in the 50% tax bracket makes a $10,000 investment in a new medical instruments company. Let us assume further that the value of that investment increases by 500% over five years, in other words, to $50,000. With a 20% capital gains tax rate, his after tax rate of return would be 33%. With a zero capital gains tax rate, as proposed in S. 1310, his rate of return would be only 38%. In my judgment, 500 basis points will not persuade otherwise risk averse investors to take their money out of suburban business parks and put it in depressed areas.

Rather than this incentive, I would propose that investors who purchase equity in a stock of unaffiliated enterprise zone companies be allowed

(a) to write off 100% of the investment that year and

(b) to defer capital gains taxes on the sale of any enterprise zone investment as long as the proceeds are reinvested in a similar eligible company.

Under this tandem of incentives, my hypothetical investor would be able to deduct the entire amount of his purchase in the medical instruments company in the year in which he acquired it giving him the equivalent of an immediate $5,000 return on his investment. Further, as long as he kept the amount of his original investment at risk within that enterprise zone or a similar one elsewhere, capital gains taxes on his investment would be deferred, although not entirely eliminated. The effect of these proposed changes would be to increase the investor's after tax rate of return from the current bill's 38% to approximately 44%, a margin of difference which might change investor risk preferences sufficiently to make enterprise zones competitive with investments elsewhere.

- The exclusion from taxable income of 50% of the income earned from enterprise zones.

This incentive would allow both operating companies and lenders doing business in enterprise zones to reduce their income tax liabilities by up to 25%. A reduction in the taxes paid on enterprise zone interest income represents a sound way of compensating commercial banks and other financial institutions which pay taxes at corporate rates for assuming the apparent risks and costs of financing the young volatile firms which enterprise zones should be designed to incubate. This measure might also help achieve needed reductions in interest rates for fledging borrowers.

I do, however, have some misgivings about providing the same tax concession to operating companies. Since, like any tax deduction, the proposed incentive increases in value with the marginal tax rate of the firm which receives it, it is obviously more valuable to profitable, well-established corporations than the young firms toward which enterprise zones should be oriented. Since almost all evidence on corporate location decisions shows that capital and tax incentives provided to such corporations are wasted, this provision may encourage tax avoidance on the part of big corporations without offsetting employment and development benefits.

As a substitute provision, I would recommend permitting tax reductions only on the interest and income earned on enterprise zone investments and loans provided by financial institutions and individuals.

In addition to removing at least one opportunity for tax abuse, this change, in combination with the immediate write-off and capital gains proposals mentioned earlier, would end up costing the Treasury substantially less than the current provisions in S. 1310. That is to say, under S. 1310, my hypothetical medical instruments company, which by the third or fourth year would be making profits, would have its taxable income reduced by up to 25% for up to 16 years. The income foregone by the Treasury could be enormous. In addition, the Treasury would also suffer a loss through the elimination of capital gains taxes. Under the proposals I have advanced, the Treasury would suffer a one time loss of $5,000. In exchange it would get a flow of regular corporate income tax payments from the subsequently profitable company, and would receive the full value of capital gains taxes paid by the investor upon the sale of his appreciated stock.

- Optional cash accounting method for businesses of up to $2 million of gross revenue.

  Of all the incentives suggested by S. 1310, this one could be most valuable to small firms since it would enable even those without profits to conserve their cash. On the negative side, it would be more valuable to companies dealing with retail and wholesale inventories than those in manufacturing, service, and information industries. I am also worried that this particular device would encourage a variety of questionable tax practices. For example, it could spawn the establishment of job-poor warehousing operations designed only to accommodate retailers and wholesalers desiring to ship inventory in and out of the zone for tax purposes. To reduce the likelihood of fraud and abuse, I would recommend that firms be allowed to use this accounting method for only the first three years of their operation within the zone.

Extension of net operating loss carry forward to 20 years.

This provision has one principal advantage and one critical disadvantage. On the one hand it would not appear to cost the Treasury much money, but on the other, it would not seem to represent an inducement important to the business location decision of most entrepreneurs. On balance, however, I believe the provision should be retained as it is.

Having commented upon S. 1310's proposed tax incentives and having offered substitute provisions where I think appropriate, I would now like to suggest two entirely new incentives:

- An extension of the existing broadcast tax certificate to any enterprise zone business sold to a minority or employee group.

Under current law, broadcast property owners who sell properties to members of minority groups are entitled to a 27% tax certificate. The evidence thus far shows that the availability of this certificate has played a critical role in increasing broadcast property ownership by blacks and other minorities. Given the experimental nature of enterprise zones, it would seem useful to see if rather such an incentive would work if applied to any enterprise zone company sold to its employees or members of minority groups.

- A supplemental Federal neighborhood assistance tax credit.

Several states -- Pennsylvania, Florida, and Missouri among them -- allow corporations to write off contributions made to qualified neighborhood development organizations and activities. I would propose that S. 1310 be amended to give corporations which qualify for state tax credits a Federal tax credit of 50% of the difference between the allowable state tax credit and the corporation's contribution. Thus a corporation which made a contribution of $500,000 for which it was entitled to a $250,000 credit against its state taxes would be given an additional credit of $125,000 against its Federal taxes.

In these days of declining Federal funds for a variety of neighborhood and local development activities, such a provision might induce more state governments to pass laws similar to those now existing in Florida, Missouri and Pennsylvania and encourage greater contributions to local development activities by major corporations.

Summing up, the changes I have recommended would, in my judgment:

(a) Improve the cash flow of young firms by allowing them to reduce their regular payroll tax contributions by the amount of anticipated credits.

(b) Enable enterprise zone job seekers to invest in job training by providing a $2,500 voucher or refundable tax credit.

(c) Increase the margin between enterprise zone investments and conventional investments elsewhere thus making enterprise zones more attractive and competitive places to invest.

(d) Remove wasteful incentives designed to influence location decisions of established profitable companies since most research shows that such companies make their location decisions based upon factors other than the availability of tax incentives.

(e) Reduce the cost of enterprise zone tax incentives to the Treasury by eliminating tax reductions on the operating income of enterprise zone firms.

(f) Encourage more widespread ownership of enterprise zone firms by applying the existing broadcast tax certificate to the sale of zone companies to minority and employee groups.

(g) Encourage increased state and private sector funding of enterprise zone activities through a supplemental Federal neighborhood assistance tax credit.

The Extent to Which the Value of Incentives Offered in Enterprise Zones Will Be Affected by Upcoming Changes in the Tax Code

This is a matter upon which I will touch only briefly. S. 1310, or for that matter, any measure designed to use the tax system to generate increased investment and economic activity in depressed areas can be successful only to the extent that the tax incentives offered compensate investors, lenders and entrepreneurs adequately for the added cost and risk for putting time, money and talent into otherwise unattractive places. Bluntly, investments in such places must offer a much higher rate of return than similar investments elsewhere. I believe the tax proposals which I have suggested would achieve this essential differential at a minimal cost to the Treasury. Yet, it is also true that the comparative tax advantage which enterprise zone investments could enjoy under the current or amended S. 1310 could be dramatically reduced or lost entirely if certain changes in the tax code now before the Congress come to pass. Let me give two examples. Several business groups, the Business Roundtable among them, have suggested the complete elimination of capital gains taxes as a strategy for speeding the nation's economic recovery. In addition, S. 360, the Omnibus Small Business Capital Formation Act proposes the deferral of capital gains taxes on certain qualifying investments. The adoption of either of these measures would reduce the value of the capital gains incentives which I have discussed today substantially. That is to say, given the same rates of return investors will always choose Houston over the hollows of Kentucky.

The reduction or elimination of corporate income taxes is another matter which the Congress is now considering. The House Ways and Means Committee recently approved a plan which would reduce the corporate income tax range from its current 17-46% to 15-43%. This change or the integration of corporate or personal income taxes which others have proposed would have the effect of making enterprise zone income tax reductions entirely meaningless.

My purpose in mentioning these proposals is not to argue for or against them on their own merits. Rather, it is to urge the Committee to recognize the need to fashion enterprise zone tax incentives with a sharp eye on other tax changes which the Senate Finance Committee and the House Ways and Means Committee are considering.

Thank you.

STATEMENT OF GREGORY J. AHART, DIRECTOR, MANPOWER AND WELFARE DIVISION, GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Subcommittee we are pleased to be here today to discuss the results of our review of the operation of the Federal-State Employment Service System. Our discussion today will focus primarily on those specific matters in which you have expressed particular interest and provide some background and our suggestions for improving the program. We plan to discuss

1. The general performance level of the Service in terms of statistical indicators.
2. Our observations with regard to the use being made of the Job Information Service.
3. The results of the use of computers by local Service offices to match applicants with job openings.
4. The effectiveness of the Service as a means of applying the work-test requirement for unemployment insurance recipients.
5. The efforts being made by the Service to obtain more job listings through better service to prospective employers.

Our review was conducted at 15 local Service offices in eight metropolitan areas: Los Angeles, California; Denver, Colorado; Chicago, Illinois; New Orleans, Louisiana; Camden, New Jersey; Philadelphia, Pennsylvania; Dallas, Texas; and Salt Lake City, Utah. These locations were selected to provide a broad geographic distribution of metropolitan areas with varying unemployment rates. Two local offices--one urban and one suburban--were selected in each area visited, except in Salt Lake City where only an urban office was selected. That office accounted for nearly half of Utah's activity.

We also sent questionnaires to a random sample of 800 employers, 600 applicants whom local offices had reported as being hired, and 600 applicants who were still seeking employment through the Service, asking them to comment on their relationship with the Service, other placement sources, and their evaluation of how effective the Service was in meeting their needs. We received and evaluated replies from 570 employers and 762 applicants.

BACKGROUND

The Service was established under the Wagner-Peyser Act in 1933 to serve as a labor exchange for persons seeking work and employers with jobs to fill. The Service is a cooperative Federal-State system of over 2,400 local employment offices in the 50 States, Puerto Rico, Guam, the Virgin Islands, and the District of Columbia. In addition to finding jobs for people and people for jobs, the Service also makes available counseling, testing and other manpower services to job seekers. Services offered to employers include assistance in developing job skill requirements and providing labor market information.

In addition to its labor exchange mission, the Service is involved in the administration of 21 other laws, 11 Executive Orders, and 14 agreements with various Federal agencies, which require the performance of specific duties relating to special target groups such as Vietnam era veterans, the handicapped, recipients of financial assistance under the Aid to Families with Dependent Children program, food stamp recipients and workers engaged in training under the Comprehensive Employment and Training Act. A major responsibility of the Service is to administer the so-called work-test for unemployment insurance claimants. The law establishing the Insurance program has been interpreted to require availability for employment as a precondition for eligibility to collect unemployment compensation.

The Department of Labor allocates funds to the States for Service operations primarily by means of a Balanced Placement Formula. The formula is used to allocate funds based on performance. Since the formula ties directly to performance, it is intended to serve as an incentive for the continuing improvement of both quantity and quality of services rendered. The formula also serves as an instrument to assist State agencies in evaluating their performance.

Although funding for the Service's activities has increased over the last 10 years, the number of staff positions has remained fairly constant, decreasing slightly in recent years. In fiscal year 1967, about $287.9 million was obligated, funding about 31,500 positions. In fiscal year 1976, the Department estimates it will obligate about $517.4 million to fund 28,400 staff positions.

PERFORMANCE OF THE SERVICE

The Employment Security Automated Reporting System is the Department of Labor prescribed statistics gathering system for the Service. It is designed to provide data on the characteristics of individuals served and on the services provided to them.

National data showed that during fiscal year 1975 about 18.5 million persons applied to the Service for assistance. Our analysis of the data showed that about 10.8 million or 58 percent of the 18.5 million applicants did not receive service of any kind, that is, did not receive job referral, counseling, or testing.

Using the national data we compared the Service's performance in fiscal year 1975 in placing applicants in jobs and filling job openings listed by employers with the goals established by the Department of Labor.

Our comparison showed that the Service had placed 3.1 million or 17 percent of its 18.5 million applicants in jobs. This performance was below the established goal of 22 percent. On the other hand, the Service had exceeded the Department's established goal of filling 60 percent of the job openings listed by employers. Data showed that 5.8 million or 73 percent of the 7.9 million job openings were filled. The difference between the data on placements, 3.1 million applicants, and jobs filled, 5.8 million, results from the fact that many of the jobs listed are for a short duration. For example, about 53 percent of the jobs listed with the Service were expected to last less than 5 months. Consequently, many applicants were placed in several jobs during the year.

Most of the placements were in relatively low paying jobs. For example, 55 percent of the placements during fiscal year 1975 were in jobs paying less than $2.50 an hour. Also, many of the jobs listed with the Service were with employers who were not subject to the Federal minimum wage laws. ($2.10 an hour in 1975.) We noted that about one-third of the placements made in fiscal year 1975 were in jobs which paid $2.00 an hour or less.

Of the 18.5 million persons registered with the Service, 6.5 million were unemployment insurance claimants. The Service found jobs for only 550,000 or 8.5 percent of the total claimants registered with the Service. The relatively low success rate in placing claimants is evidenced by the fact they comprised 35 percent of the total number of applicants, yet accounted for only about 18 percent of the persons placed in jobs.

As previously stated, the Employment Security Automated Reporting System is the Department of Labor prescribed statistical data gathering system for the Service and is the only source from which information on performance can be obtained. During our review, we noted that the data did not always accurately reflect performance. A Department study of 1974 placement data in four States also showed errors had occurred in the accumulation of the data.

Errors in placement data

At each of the eight metropolitan offices we visited, we sent questionnaires to 75 randomly selected applicants who had been recorded by the office as being placed in a job during February 1975. One of the purposes of the questionnaire was to verify that the applicants had found a job through the Service office. Of the 600 questionnaires sent, we received responses from 337 persons. Only 189, or 56 percent, of those responding stated that they had actually been placed in a job by the Service offices. The remaining respondents stated they did not find jobs or found jobs by other means.

Service officials said that reporting errors can occur in several ways including:

--Applicant was hired but never reported for work. The local office may have verified that the applicant was hired but did not follow up to determine if the applicant actually entered on the job.

--Employer did not hire the applicant. The local office recorded the placement without verifying that the applicant was hired.

--Clerical or keypunch error. The local office erroneously input the referral result as hired or recorded the wrong applicant as being placed.

A Department study of fiscal year 1974 data in Illinois, New Mexico, North Carolina, and Oregon also identified invalid placements. The study showed that about 5,000, or 15 percent, of 34,000 reported placements in the four States were invalid. The report identified major causes of erroneous placements which were similar to those I just described.

In addition to overstating the number of placements, we found that the data did not always accurately reflect the duration of the jobs filled. The Service categorizes placements by expected duration--1 to 3 days, 4 to 150 days, and over 150 days. The job duration is determined at the time a job order is received from an employer and is based on the employer's opinion as to how long the job will last. The Department considers placements expected to last over 150 days as permanent jobs.

To test the actual duration of permanent placements, we randomly selected 328 reported placements in jobs expected to last over 150 days, and telephoned the employers 30 days after the reported hire date. After one month, only 52 percent of the applicants were still working. The Department's study showed similar results--about 15,600, or 66 percent, of almost 24,000 persons reported placed in permanent jobs were not longer employed at the end of 150 days.

Effect of inaccurate reports

State and local office managers use the Employment Security Automated Reporting System data to compare their performance with established goals each quarter. The Department requires that any unfavorable variances be explained and corrective actions taken. Errors in performance reports affect these evaluations and could result in inappropriate management decisions.

The Department allocates about 60 percent of Service funds to the States on the basis of their reported performance.[1] A State's funding depends on how its performance compares to the national average. Because the formula consists essentially of measures of individuals served, job orders filled and the duration of the jobs, errors in performance data directly affect the funds received by States. To illustrate, we recomputed one of the larger State's funding allocation for fiscal year 1976, assuming that it overstated individuals placed and jobs filled by 10 percent, and the duration of placements by 25 percent. Under these assumed overstatements of performance this State's funding would have increased by about $2 million or 6.5 percent of its $30.7 million allocation.

JOB INFORMATION SERVICE

The Job Information Service is a technique whereby an applicant can review job openings and be referred to one he selects without an extensive interview and registration process. The applicant does much of the job screening usually done by interviewers in individualized service. Service offices using the Information Service usually make available to interested applicants a display of available job listings on bulletin boards or TV-like viewers.

The Department introduced the Information Service concept on a national basis in 1971 after successful experiments in 10 cities. These experiments showed that 35 to 40 percent of an office's applicant workload could be adequately served by the Information Service with a minimum of assistance from office personnel. In 1975, a Department official estimated that at offices using the Information Service, 60 percent of the placements could be attributed to the system.

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[1] The remaining 40 percent is allocated on a specific funding basis for activities such as rent, postage, and other nonplacement items .

The Department engaged a contractor in 1975 to examine the use of the Information Service in local offices. A mail survey and follow-up telephone survey by the contractor in August 1975 indicated that about 1,000 of the approximately 2,400 Service offices had some type of Information Service, varying from a single viewer or hard copy of job orders to many viewers and job search materials. Available information also showed that the use of the Information Service varied among States. For example, only 3 of 43 offices in Massachusetts reportedly used the system compared with 20 of 22 Connecticut offices. The Information Service was reportedly not used in large metropolitan areas such as New York City, Indianapolis, and Oklahoma City.

Thirteen of the 15 offices we reviewed used the Information Service to varying degrees. The remaining two offices did not use the system. At the total of seven offices located in Dallas, Denver, Los Angeles, and Salt Lake City, applicants were encouraged to use the self-service screening system and it accounted for many referrals. For example, about 85 percent of the referrals at one office in Los Angeles resulted from the Information Service. It was used less at each of the two offices in Chicago and Philadelphia. These offices relied more on interviewers matching applicants with the jobs and the Information Service was not as large a factor in making referrals. For example, at a Chicago office, only 10 percent of the referrals to jobs were attributed to the self-service system. Although the two New Jersey offices were equipped to operate an Information Service, the job data that was displayed was a week old and not useful to the applicants. As a result the system was not used. The two offices we reviewed in New Orleans did not have an Information Service and relied totally on interviewers matching applicants with the jobs.

Because the Information Service requires that an applicant visit the Service office, we included in our questionnaire to applicants questions concerning the accessibility of the offices to the applicants. Based on the results of the questionnaire we found that 86 percent of the applicants lived within 10 miles of an office, and 73 percent resided within 20 minutes of the offices. Most of the applicants responding to our questionnaire advised that the self-service system was easy to use and a good way to present available jobs.

During our discussions with managers of offices using the Information Service all but one stated that without it more staff would be needed to maintain the present level of service. For example, at the Denver urban office, which relies heavily on the Information Service, the manager estimated that his present staff of 24 would have to be increased to about 50 persons if the system was not used. Most managers stated that in addition to freeing personnel, the Information Service

- --enables applicants to review and consider a wider range of jobs;
- --lets applicants quickly determine if a suitable job opening is available;
- --increases the number of job referrals; and
- --increases the frequency of applicants visiting the Service.

We found that over two-thirds of the job referrals occurred while the applicant visited a Service office and was served by the Information

Service and/or individualized service. The remaining referrals resulted from a process called file search.

File search occurs when, in the applicant's absence, an interviewer uses a previously completed application to match the applicant with a job opening. File search can sometimes produce referrals to jobs not filled by persons visiting an office. However, the effectiveness of file search is hampered by the volume and quality of applications, lack of time, and difficulty in contacting applicants.

We randomly selected 375 unfilled job orders--25 at each of the 15 local offices--and searched applicant files to see how many applicants were suitable for each job order. Our file search revealed that there was at least one applicant qualified for 160, or 43 percent of the 375 unfilled jobs. In addition, there were three or more qualified applicants for 25 percent of the jobs.

Service office personnel generally agreed that the matches we made were valid. They said they had not made the matches primarily because of insufficient time available for file search.

There were other problems with regard to the effectiveness of file search as a means of matching job openings with qualified applicants.

Applications at some offices were often not useful for file searching either because the applicants were no longer seeking employment or because the applications did not contain sufficient information on the applicants' qualifications. For example, 69 of the 100 applications we reviewed in New Jersey were not useful for file search for these reasons. About 90 percent of the applications reviewed in the two Chicago offices did not show the applicant's minimum acceptable salary.

We also found that file search is often unproductive because applicants when matched with job openings often cannot be reached to refer them to the jobs. At each of the 15 offices, we randomly selected 50 active applicants and attempted to reach them by telephone. About two-thirds of the 750 applicants could not be reached or were not available for job referral. The primary reasons included no phone, the phone was out of service, or the person was already employed. In Utah, the Service notified applicants by mail about possible job referrals if they did not have telephones. Like the telephone contacts, the response rate to the mail cards was about 25 percent.

COMPUTERIZED JOB MATCHING

A computerized matching system is basically one of automated file search in which a computer matches a job's requirements with applicants' qualifications. The Department began computer matching experiments in four States--New York, Wisconsin, California, and Utah--in the 1960's. The Department established a 5-year plan starting in fiscal year 1976 to expand computerized matching nationwide at an estimated cost of $100 million.

We found that the effectiveness of computerized job matching, like manual file search, is limited by the volume of applications, time factors, and difficulty in contacting applicants. We included Salt Lake City in our review because the Department considered it to have an excellent computerized matching system. We found that the computer accounted for 29 percent of the job referrals at the Salt Lake City office--a level not substantially different from the levels achieved by offices performing manual file search.

Utah officials stated that about 60 percent of the computer matches were not used because interviewers

--determined the match was not suitable because of such factors as the registrant's work history, or attitude, or transportation problems, or

--were too busy serving applicants in the office to review computer matches.

The officials estimated that half of the remaining matches were not used because the Service was unable to contact the registrants to refer them to jobs.

The Salt Lake City office had about 20,000 applications on file in the computer. Although the computer's speed handled this volume, the matches that resulted included persons not actively seeking or available for work. We also observed that interviewers did not have time to review all job matches.

We randomly selected 50 active applicants and attempted to reach them by telephone. Thirty-nine or 78 percent of the applicants we selected either could not be contacted or were not available for a referral. Nine of the 20 persons we were able to contact were no longer seeking employment.

The computer does not guarantee that all possible referrals will be made. We selected 24 jobs which the Salt Lake City office had not filled. Each job had been open for at least 5 days. With the help of Service personnel, we used the computer to match available applicants to the jobs. Twenty-nine suitable applicants were available for 9 of the 24 job openings. The Salt Lake City office had referred only one person to one of the nine jobs.

EFFECTIVENESS OF WORK-TEST

In order to collect unemployment insurance a claimant must meet the requirements of the "work-test" rule. The rule requires a claimant to be available for and actively seeking suitable work. To comply with the work test rule applicants are generally required to register with the Service.

The Department's operating instructions require the Service to report to the Unemployment Insurance office any information it obtains regarding a claimant's availability for work. The Service is to report instances when a claimant:

--refuses a referral or does not respond to a request to come in for a referral;

--does not appear for a job interview;

--declines a job offer;

--does not report for work after accepting a job; or

--by some action or statement leads the Service to question his availability for work.

During fiscal year 1975, the Service reported to Unemployment Insurance offices on about 206,000 claimants who may not have complied with the work-test. Only about 60,000, or 29 percent, of these reports resulted in claimants losing benefits. These persons represented about 1 percent of the 6.5 million claimants registered with the Service. Many eligibility questions do not result in disqualification from benefits because Unemployment Insurance office staff (1) cannot obtain sufficient evidence that a claimant did not appear for a job interview and (2) are uncertain about what claimant actions indicated unavailability for work.

We examined 331 randomly selected Service reports questioning claimants' eligibility of which only 30 resulted in disqualification of benefits. In many instances the claimant was not disqualified because the reports could not be substantiated. For example, claimants often stated that they appeared for job interviews and the Unemployment Insurance office staff could not obtain substantive evidence from the prospective employer that the claimant did not appear. Also, the staff often excused claimants when they did not appear for a job interview because the claimants said the job location was inconvenient or the pay inadequate. This occurred despite the fact the claimants knew the location and wages of the jobs before accepting referrals.

Other factors which influence the effectiveness of the Service as a means of applying the work-test rule are the relatively low paying jobs that are listed and the fact that certain groups of claimants generally cannot benefit from Service assistance. As stated previously, the Service has had relatively little success in finding jobs for claimants--placing only 550,000 or 8.5 percent of the approximately 6.5 million claimants during fiscal year 1975.

The low pay of many jobs listed at the Service makes it difficult to refer and place claimants. For example, in the eight States reviewed the average weekly insurance benefit for a single person ranged from 59 to 94 percent of the average wage after taxes of jobs listed at the Service.

The Department specifically identified the following groups of claimants who could be exempted from Service registration for purposes of the work-test requirements: (1) claimants having a continuing job attachment with reasonable assurance that employment will be resumed, (2) workers who perform jobs available exclusively through unions in which they are in good standing, and (3) individuals in occupations where placement customarily is made by other nonfee charging placement facilities such as professional associations.

Studies sponsored by the Department between 1969 and 1973 showed that about 40 percent of all claimants would not appreciably benefit from employment assistance from the Service, and therefore their registration would not constitute a valid work-test. Applying the results of these studies to the workload of 16 States for fiscal year 1973, the Department estimated that these States completed 1.4 million work registrations for claimants in this category.

In cases where registration with the Service does not provide a work-test, other means can be used to provide reemployment assistance to claimants and legitimately apply the work-test. For example, the Department has suggested that Unemployment Insurance office staff conduct periodic indepth eligibility interviews with claimants geared toward determining their active work search efforts. In addition, these interviews can be used to provide information to the claimant about the job market.

Efforts to reduce workload

Several States attempted to reduce the registration workload in various ways during fiscal years 1974 and 1975. California adopted a temporary policy to accommodate the increased workload generated by a high unemployment situation. For example, the suburban Los Angeles office completed detailed applications only for:

- --claimants with occupations for which 10 or more job openings were currently available;

- --recently discharged veterans who were also claimants; and
- --food stamp recipients.

The time spent on applications decreased 30 percent with the policy change. However, this registration policy was scheduled to end when unemployment normalized.

In Dallas the offices registered most claimants, but allowed them to review job listings or request interviewer assistance on a voluntary basis. We observed during a 3-day test period that about 40 percent of the claimants chose not to consider the jobs listed at the Service.

On October 1, 1974, New Jersey ended mandatory Service registration of claimants. Instead, the State invited claimants to register with the Service if they wanted or needed help in finding a job. New Jersey compared the experience of the first 6 months under the new policy with the same period during the previous year. Total registrations decreased by over 50 percent, but New Jersey was able to place nearly the same number of individuals during the test period as it did during the previous period. This occurred despite a 32 percent drop in the number of jobs listed which was largely attributable to an increased unemployment rate. The director of the New Jersey agency drew the following conclusions from the study.

- --The Service is much more effective in placing persons who are not claimants.
- --Claimants who voluntarily register are more likely to be placed than involuntary registrants.
- --The Service can provide a more effective placement service to both applicants and employers under the voluntary registration system.

The Director also stated that the reduced registration workload allowed 40 personnel to be diverted from registering applicants to placement activities. He believed that 2,400 fewer placements would have occurred if the 40 reassigned personnel had to complete registrations instead of being freed to perform placement duties.

EMPLOYER SERVICES

The primary purpose of the employer services program is to generate an inflow of job openings in the volume and occupational variety necessary to satisfy the job needs of applicants.

One of the principal elements in a good employer relations program is personal contact with potential employers to encourage their use of the Service for meeting their personnel requirements.

At the time of our review, the Department had not established staffing standards for employer relations at local offices. Understandably, the level of local employer relations activities varied considerably at the locations we visited.

During 1975 the Department drafted employer relations guidelines which it plans to distribute to the State agencies. The guidelines recommend that local offices should contact, by phone and/or personal visits, 25 to 46 percent of the employers in the area they serve. Selection of employers included in the contact program is to be based on placement potential indicated by factors such as (1) number of workers employed, (2) turnover rates, (3) nature and quality of openings and (4) need for placement service. A Department official advised us further that each employer included in the employer contact program should be phoned or visited a minimum of four times a year.

In Philadelphia and New Jersey, employer service representatives were assigned by local offices. At the Philadelphia suburban office, two representatives were responsible for about 500 small employers and 150 larger employers in the area. They visited about 15 percent of the small employers and a third of the larger employers each month. In addition, they contacted about 200 more employers by telephone each month. In contrast, the Camden and Burlington, New Jersey offices devoted few resources to employer services. At the Camden office one representative was assigned to service all 4,700 employers in the area; while at the Burlington office with 3,000 employers in the area, no employer representative was assigned.

Los Angeles and Denver present a similar contrast in service levels. Both localities operated regional employer service offices which were responsible for areas served by several local offices.

The office serving the Los Angeles suburban area had approximately 18,000 employers in its jurisdiction--three representatives serviced the area. Each month they visited about 400 employers in person and called about 100 others. The office serving the urban Los Angeles area allotted 4.5 personnel positions for serving 27,000 employers and making 500 contacts each month. If the new Department employer relations guidelines had been in effect during fiscal year 1975, the office serving the Los Angeles suburban area would have to have contacted between 1,500 and 2,800 employers each month, and the urban office between 2,300 and 4,100. Service officials stated that additional personnel were not available to provide the needed employer relations services.

Denver maintained a higher level of employer relations activities. Both offices in Denver were served by staff assigned to the same regional office which was responsible for about 20,000 employers. The office was staffed with an employer relations supervisor, nine employment service representatives, and four staff assistants. In a typical month the staff contacted about 1,200 employers by telephone or in person.

A good employer relations program also involves providing the kind of service to employers that will create confidence in the Service as a reliable source for meeting all of their personnel needs.

We sent questionnaires to 800 employers to obtain their views on the effectiveness of the Service. Analysis of the 570 returned questionnaires showed that although employers are not charged for services, almost 60 percent of the employers did not list all their job openings with the Service. We compared the type of jobs employers listed to the occupations of persons they employed, and found that most respondents employing clerical workers, laborers, and equipment operators listed those kinds of jobs with the Service. However, only 10 percent of the employers having managerial employees listed that kind of position. Similarly, less than 25 percent of the employers with professional positions, for example accountants and engineers, listed these openings.

We asked employers to rate the effectiveness of referral services in terms of applicants' qualifications, the number of referrals sent, and timeliness for each of nine job classes. Employers ranked skilled workers, managers, and professionals as the three occupations least effectively serviced; and service workers, laborers, and equipment operators as the most effectively served groups.

Most employers did not rank the Service as their first choice for referrals. They ranked newspaper ads and referrals by existing employees ahead of the Service.

We randomly selected a total of 369 job orders which had not been filled at the 15 offices reviewed. Telephone contacts with the employers disclosed that 279 (76 percent) of the jobs had been filled by other means. Newspaper ads, personal referrals, walk-ins, and private agencies were the major sources of referral. About one-third of the employers said they were dissatisfied with the Service primarily because of the poor quality of applicants referred and an insufficient number of referrals.

All the questionnaire respondents reportedly listed jobs with the Service, but only 55 percent of the employers stated they had been contacted by Service staff in the past year. Most respondents also said they had not changed their use of the Service in the past 3 years. According to the employers, the most important services employer relations personnel could provide were (1) to learn about employer personnel needs, (2) expedite referral service, and (3) solicit job orders.

- - - -

Before concluding, I would like to provide a brief description of the changing role of the Service since its inception, a summary of the information we have provided and our suggestions for improving the performance of the Service.

Since its establishment in 1933, the Service's focus and the labor market in which it participates have changed. Unlike 1933, the Service now competes with a multitude of other placement activities. From that competition, it emerges as an agency serving a relatively small and specialized segment of the labor market--jobs and persons characterized by low pay.

Originally conceived as a labor-exchange for persons seeking work and employers with job openings to fill, the Service took on a broader range of manpower activities as part of the World War II effort. In the face of acute manpower shortages, it assisted in recruitment and manpower utilization activities.

Another big change in focus occurred in the late 1960's and early 1970's. In line with the legislative emphasis on the disadvantaged, the Service provided intensified and individualized service to people who experienced the most difficulty in getting and holding jobs. This emphasis diverted attention from the job-ready and resulted in a sharp decline in job orders and placements. The number of nonagricultural placements dropped from 6.6 million in 1966 to 3.3 million in 1971.

After 1971 emphasis turned to increased placement of all people, the job-ready and the disadvantaged. Increased productivity (more placements) as well as placement of individuals in certain target groups was emphasized. The Department plans to expand the Service's penetration in the labor market from the fiscal year 1975 level of 6.3 million nonagricultural job openings to 8.5 million listings by fiscal year 1979.

In August 1974 the Bureau of Labor Statistics (BLS) reported on its study of how people found employment. The statistical study pertained to 10 million persons who sought and found work during 1972. BLS reported that although a third of the job seekers used the Service, 95 percent of the job placements occurred through other means. The major sources were: applications directly to employers (35 percent), friends and relatives (26 percent), and newspaper ads (14 percent). Private employment agencies and the Service each accounted for about 5 percent of the placements.

The BLS study also showed the occupations and education levels of the people placed by the various employment sources. The Service accounted for only 1.8 percent of the professional and managerial job placements. It was more successful with clerical workers (6.7 percent), service workers (5.7 percent), and nonfarm laborers (5.9 percent). Similarly, the Service accounted for 9.6 percent of the persons placed who completed 8 or less years of school, but only 2.4 percent of the placements of college graduates.

The BLS findings are consistent with our analysis of Service performance reports. Our analysis showed that the Service is primarily a placement service for low-paying jobs. Almost 55 percent of the placements during fiscal year 1975 were in jobs paying less than $2.50 an hour; and one-third paid $2.00 or less an hour. During the year, the Service spent an estimated $491 million to place 3.1 million persons--an average cost of $158 for each individual placed.

The Department plans to achieve more and better job placements by spending substantial sums to establish computerized job matching nationwide and improving employer relations. Because the Service does not create new jobs, it increases its performance by obtaining a greater portion of the placement transactions that occur in the labor market. The Department has not related the Service's expansion to an identified level of employer and applicant needs. Moreover, while the Department plans to expand the computerized job matching system, it has not been conclusively demonstrated that this system will significantly improve the Service's ability to make more timely or accurate job matches.

Since there are many competing sources for filling jobs, the Service in order to improve its performance must match applicants with available jobs quickly. The Department plans to implement computerized job matching on a nationwide basis, however, this process is subject to many of the same problems associated with manual file search. We suggest that before incurring the cost of implementing the computerized job matching system nationwide, the Department reevaluate the benefits that could be achieved by the system.

We believe that the less costly Information Service enables the Service to provide its applicants the opportunity to consider a wider range of available jobs, facilitates a more timely match of applicants with job openings, and should enhance their chances in being placed in a job. Therefore, we suggest that the Department identify those offices which could improve their performance by implementing the Information Service and encourage them to establish such systems.

Since the Service has many more applicants than available jobs, its employer services program is particularly important if it is going to obtain more job openings. The Department has established criteria for personal visits and telephone contacts that employer services staff should make to employers and has established a broad goal to obtain a larger share of job openings. However, the program lacks direction in terms of the kinds of job openings that should be sought. As stated previously, the Service has, over the past years, acquired the image of a labor exchange function for low paying, short duration jobs. This has not only hampered the Service's ability to improve its performance, but has reduced its effectiveness in enforcement of the work-test rule for unemployment insurance recipients.

We suggest that the Department establish goals that would encourage the Service to upgrade the types of jobs that it can offer its applicants and to seek a wider range of jobs to better meet the needs of a larger number of its applicants.

We suggest that the Department examine the application of the work-test rule to determine why it has been largely ineffective.

The accuracy of data produced by the Employment Security Automated Reporting System is important to the management of the Service at the local, State, and Federal levels. Without accurate performance data, success in placing applicants and filling jobs cannot be reliably measured or evaluated and resources applied equitably. Therefore, we suggest that the Department take the action necessary to insure that the Service verify the validity of reported placements and that adequate follow-up is made to verify the accuracy of the reported duration of the placements.

Mr. Chairman, this concludes our prepared statement. We will be pleased to respond to any questions that you or other members of the Subcommittee may have.

SYNOPSIS

of

UNITED STATES GENERAL ACCOUNTING OFFICE

Report dated May 24, 1976

By Gregory J. Ahart, Director

on

THE OPERATION OF THE FEDERAL-STATE EMPLOYMENT SERVICE SYSTEM

BY: Dr. Robert O. Snelling, Sr.

This report clearly and undeniably castigates the United States Employment Service and its 2400 State Employment Offices and its 28,400 employees for their unbelievably poor showing.

a. They are placing virtually no one, and this is especially true of the unemployed. Although they claim to have placed 3.1 million out of 18.5 million applicants, or 17% in permanent positions, the facts of the report show that it is more like placing 385,000 out of 18.5 million, or 2% (page 4). Fifty-eight percent of the applicants did not even get a job referral, counseling or service of any kind (page 3). Sixty to eighty-five percent of the applicants placed themselves (page 8). Only 8% of their placements were unemployment compensation claimants (page 4). Yet for 25% of the jobs they had on file, they also had three or more qualified applicants in their files, and 43% of the jobs on file had at least one qualified applicant in their files (page 10). They admit their placements dropped from 6.6 million in 1966 to 3.1 million in 1975 (page 21), but blame it on other jobs they were required to do. In view of the fact that the bulk of these placements were temporary in nature (see paragraph b), their demise in placements was due to the amazing growth of the temporary help industry (private enterprise) in this country during the same period. The temporary help industry employed over 2,000,000 people most of whom were placed on more than one assignment with a payroll totaling over 1.5 billion.

b. They are falsifying their figures by huge amounts in order to obtain more federal funds. This amounted to well over $2 million in one state alone (page 7). Fifty-six percent of the people who they claimed they had placed said the state had not placed them (page 5). Fifty-two to sixty-six percent of those claimed as permanent placements, over 150 days, were not (page 6). The U.S.E.S. claims 5% of the nation's placements (page 22). Their number of claimed placements, 3.1 million (page 4) would then interpolate into an astounding 62 million placements. Additionally, the U.S.E.S. claims one-third of the job-seekers use them (page 21). They claim that 18.5 million job-seekers use them (page 3.) This would mean an astounding 55.5 million job-seekers. Therefore, the 3.1 million is patently false, since it is inconceivable that 65 to 73% (depending on which of their figures you choose to use) of our 85 million work force would change permanent jobs in one year. On the other hand, using their own figures (see paragraph f) a placement record of 385,000 permanent jobs would be more in keeping and result in a 7.7 million permanent job changes per year, or approximately 12 to 14% of our work force.

c. They are unilaterally, without proper legislation, changing their objective from placing the unemployed to placing the employed. While 86% of their applicants are within 10 miles of their present offices, they are planning on and moving to open new offices in suburban areas away from those unemployed applicants (page 9). They openly admit they are more effective in placing persons who are not unemployment compensation claimants (page 16), and they readily admit they are changing their focus from the intent of the Wagner-Peyser Act from placing the unemployed to the "job ready" employed (page 20 and 21).

d. Allowing the unemployed who desire to do so to rip off the nation by not applying the "work test" rules, they managed to file a complaint against only 3% of the 6.5 million unemployment compensation claimants on the work test. And only 1% of the 6.5 million claimants were denied benefits (page 13). They are not even requiring unemployment compensation claimants to register for jobs (page 15 and 16), and G.A.O. considers the work rule as ineffective (page 24).

e. In an effort to expand their already burgeoning bureaucracy, they are expending a costly $100 million plus, which amounts to an over 20% increase in their budget, on a computer system that does not work. The results of the computerized search for referrals at their top office in the nation were no different than results from offices doing a manual search (page 11). The actual computer matches are no good; 80% were not usable (page 12). The computer is not even being used in the offices where it is in service (page 12). The G.A.O. has said that the computers have not proven feasible (page 23), however, the U.S.E.S. intends to utilize them regardless (page 22).

f. Their ineffective service is costing the nation over $1,000 per placement, which is way above what private enterprise would charge to do the same job. U.S.E.S. claims they have placed 3.1 million at an estimated cost of $491 million (although the figure is probably much higher) for a cost per placement of $158.00 (page 22). The G.A.O. study shows that 50% of 3.1 million placements is an outright falsification (page 5), thus the placements should actually have been 1.55 million. The study showed that 50% of those claimed as permanent placements (over 150 days) were in fact not. This reduces the number of placements another 775,000 leaving 775,000 actual placements (page 6). They did admit that 50% of their placements were expected to last under 150 days (some as short as 3 days). This reduces the 775,000 to about 385,000 (page 6). Dividing this into the $491 million estimated cost brings the cost per placement to $1,270.

WISCONSIN SENATE

CHAIRMAN: Aging Committee
CHAIRMAN: Business & Financial Institutions Committee
CHAIRMAN: Transportation Committee
CHAIRMAN: Legislative Council Mining Committee

TIM CULLEN
STATE SENATOR
15th District

MEMBER: Human Services Committee
MEMBER: Legislative Council
MEMBER: National Conference of State Legislatures Transportation Committee
MEMBER: National Conference of State Legislatures Subcommittee on Aging
MEMBER: National Conference of State Legislatures Special Task Force on Financial Institutions

February 10, 1981

Noah Shaw
3315 Hampshire Road
Janesville, Wisconsin 53545

Dear Mr. ~~Shaw~~: Noah,

Thank you for your recent views on the newly established employment service through the Janesville Job Service office. I would like to pursue the matter further.

Enclosed please find a copy of a letter I have written to Joseph Noll, Secretary of the Department of Industry, Labor and Human Relations, regarding the new service.

As soon as I hear from Mr. Noll, I will be in touch with you. I hope you continue to share your thoughts and comments with me on issues of concern to you.

Sincerely,

Tim

Senator Tim Cullen

TC/jd

P.S. If I can be of any further assistance in any other way, please do not hesitate to contact me.

12 SOUTH, STATE CAPITOL, MADISON, WISCONSIN 53702; (608) 266-1007
TOLL FREE LEGISLATIVE HOTLINE -- 1-800-362-9696

WISCONSIN SENATE

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TIM CULLEN
STATE SENATOR
15th District

MEMBER: Human Services Committee
MEMBER: Legislative Council
MEMBER: National Conference of State Legislatures Transportation Committee
MEMBER: National Conference of State Legislatures Subcommittee on Aging
MEMBER: National Conference of State Legislatures Special Task Force on Financial Institutions

April 7, 1981

Noah Shaw
3315 Hampshire Road
Janesville, Wisconsin 53545

Dear Mr. ~~Shaw~~: Noah,

Enclosed please find a copy of a letter I have received from Joseph Noll, Secretary of the Department of Industry, Labor and Human Relations, regarding your views on the newly established employment service through the Janesville Job Service office.

I hope Mr. Noll has answered all of your questions concerning the new operation to your satisfaction.

Please let me know if I can be of additional service to you on this or any other matter of concern.

~~Sincerely,~~

Tim

Senator Tim Cullen

TC/jd

12 SOUTH, STATE CAPITOL, MADISON, WISCONSIN 53702; (608) 266-1007
TOLL FREE LEGISLATIVE HOTLINE – 1-800-362-9696

WISCONSIN EMPLOYER COMMITTEE
JOB SERVICE IMPROVEMENT PROGRAM
(JSIP)

Business and Government
Working Together

January 2, 1981

The Honorable Wayne W. Wood
Member of Assembly
2429 Rockport Road
Janesville, WI 53545

Dear Representative Wood:

You may be surprised to get this letter from a business constituent who isn't writing to complain about something.

I simply want to inform you of a Wisconsin project that is part of a national endeavor. It is called the Job Service Improvement Program (JSIP) - Employer Committees.

I am enclosing a brochure, "Can Business and Government Work Together?" It explains the program well.

In Wisconsin, we have 40 plus local Employer Committees and a Statewide Employer Committee that I chair. We represent 655 plus employers.

We are working with the Job Service, in an advisory capacity, to improve the delivery of services.

We believe that we as employers, through the FUTA Tax, pay for a full service employment service and have a right to services we want and need.

The role of Job Service has been controversial. Should they serve only disadvantaged and the unemployed? We don't think so.

Should Job Service advertise? Some say they shouldn't. Isn't it a greater disservice to the community to have services available, paid for with tax dollars, that many are unaware of?

"Can Business and Government Work Together?" In Wisconsin, we think so.

Sincerely,

Al Phillips

Al Phillips
Manager of Employer Relations
Madison Kipp Corporation
Chairman, Wisconsin Employer Committee

AP:B. Falch:ECS16:22
Enc.

JOB
SERVICE

WAYNE W. WOOD
STATE REPRESENTATIVE
48th District

Office:
~~110 North 34 West~~
State Capitol
Madison, WI 53702
Telephone: (608) 266-9172

Home:
2429 Rockport Road
Janesville, WI 53545
Telephone: (608) 752-3790

WISCONSIN LEGISLATURE
ASSEMBLY CHAMBER
MADISON
53702

CHAIRMAN:
Joint Survey Committee on Retirement Systems
Retirement Research Committee

VICE-CHAIRMAN:
Small Business Committee

MEMBER:
Labor Committee
Local Affairs Committee
Government Operations Committee

January 15, 1981

Mr. Noah H. Shaw
Snelling & Snelling, Inc.
1821 Milton Avenue
Janesville, WI 53545

Dear Mr. Shaw:

Thank you for your note indicating your concern over the state's Job Service Office plans for promotion.

This service is in answer to businessmen's requests for a professional placement service in an effort to promote employment and reduce unemployment compensation taxes. I am enclosing a copy of a letter I received from the Wisconsin Employer Committee Chairman, explaining their reasoning.

You might also want to contact your local Chamber of Commerce with your concerns and the Wisconsin Manufacturers & Commerce. I am sure they would be interested in hearing your comments and suggestions.

Thank you for taking the time to let me know your concerns.

Sincerely,

Wayne W Wood

WAYNE W. WOOD
State Representative
48th Assembly District

W;e

February 17, 1981

Senator Tim Cullen
12 South, Capitol
Madison, Wisconsin 53702

Dear Tim:

Your sensitive response to my concern of more government spending was appreciated.

I am sure the Job Service personnel share my objectiVE of a higher percentage of placements per number of interviews, do a better job!

They have a terrific work load, with no control of traffic. I don't believe employers "wanting something for nothing" a service that is available through private enterprise, should be allowed to request a near bad situation to get even worse (at my expense).

I've shown your letter of intention to many including Tom Hornig - he commends you highly.

Thank you again, let me know if I can help you in any way.

Sincerely,

SNELLING AND SNELLING

Noah Shaw
Manager
NS/mb

WISCONSIN SENATE

CHAIRMAN: Aging Committee
CHAIRMAN: Business & Financial Institutions Committee
CHAIRMAN: Transportation Committee
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MEMBER: National Conference of State Legislatures Special Task Force on Financial Institutions

February 10, 1981

Joseph Noll
Secretary
Department of Industry, Labor and Human Relations
201 East Washington Avenue
Madison, Wisconsin 53702

Dear Joe:

I have been contacted recently by Noah H. Shaw, 3315 Hampshire Road, Janesville, regarding a new service being offered through the Janesville Job Service office.

Mr. Shaw is opposed to this program. I have enclosed a copy of the newspaper clippings, which explain the program Mr. Shaw is referring to.

What percentage of unemployed persons in the State of Wisconsin, at this time, are classified professional? Why was such a service established in Rock County where the majority of the unemployed are not professionals, but auto workers and workers from related industries?

I would appreciate your attention to this inquiry. I look forward to hearing from you.

Sincerely,

Tim

Senator Tim Cullen

TC/jd

12 SOUTH STATE CAPITOL, MADISON, WISCONSIN 53702; (608) 266-1007
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State of Wisconsin \ Department of Industry, Labor and Human Relations

Lee Sherman Dreyfus
Governor

Joseph N. Noll
Secretary

Room 401 GEF-1
201 E. Washington Avenue
P.O. Box 7946
Madison, Wisconsin 53707
Telephone 608/266-7552

MAR 3 1 1981

March 27, 1981

The Honorable Tim Cullen
State Senator
12 South, State Capitol
Madison, Wisconsin 53702

Dear Tim:

In response to your letter forwarding Noah Shaw's communication regarding the Job Service promotion, the purpose of this promotion was to get more employers, especially the smaller ones, to come into Job Service for their employment needs. We now have a ratio of twenty-five job applicants for every job opening statewide and what we desperately need are more job openings. These funds are provided by the Department of Labor for this specific purpose.

Regarding professional placement, this center in Janesville is merely a small offshoot of the only Professional Placement Center we have, and that is in Milwaukee. It is not really a staffed operation and merely offers another service to the citizens of the state. The reason we have a professional placement office is that we are under terrific pressure from the employers to provide such a service. On the one hand we have employers asking us to do this for them so that they can reduce their cost of placement, and on the other hand we have the private placement companies incensed at our performing this service. On balance, I feel that, inasmuch as the entire administrative cost of Job Service is borne by the employers of this state, we should make some attempt to meet their demands for services. Approximately 9.3% of all applicants throughout the entire state Job Service system are classified professional. In Janesville this is only 5%.

I am extremely sympathetic to the plight of especially auto workers in the Janesville area, but until General Motors gets back on its feet, I would have to realistically say there is not very much we can do for them. Most of them are drawing both unemployment compensation and TRA payments at this time and frankly are not interested in gaining employment that would actually cost them net income. That, of course, is academic inasmuch as there aren't very many jobs available at any wage level now.

I am sure you appreciate, Tim, that we are in a recession in Wisconsin as deep as any we have had since World War II. As a further example, as of today in Milwaukee we have 60,000 job applicants and 282 job openings -- a ratio of over 300-1. This obviously is not a picnic for anyone trying to find work at this time.

Best regards,

Joseph N. Noll
Secretary

pb

Irregularities Claimed

U.S. Studying State Job Service Charges

TULSA SUNDAY WORLD
Tulsa, Oklahoma, Sunday, January 30, 1977

By CHUCK ERVIN
World Capitol Bureau

OKLAHOMA CITY — Two federal agencies have confirmed they are studying allegations of illegal activities in the Oklahoma Employment Service.

The Oklahoma City office of the FBI confirmed it is making preliminary inquiries to determine if an investigation is warranted.

A spokesman for the U.S. Labor Department's regional office in Dallas also said it will soon begin checking on the state agency as a result of complaints about operations in the employment service.

Russell Reinoehl, a Labor Department employe in Dallas, shied away from the word "investigation" but said the federal agency will soon begin a "validation audit" to determine if job placements claimed by the employment service are valid.

If large numbers of invalid placements turn up, the inquiry would be broadened to include charges that massive falsification of records have taken place in the state agency.

It was learned that the Labor Department received an anonymous complaint, alleging illegal practices, including falsification of job placement reports and records.

Gov. David Boren's office has received a similar complaint.

A spokesman for the governor said he has asked the employment service to check into the allegations and that he has been assured that the agency will work with the Department of Labor to conduct an audit.

Although the employment service is a state agency, it is funded by the federal government through the Department of Labor.

The number of job placements is one factor in determining the amount of funds going to the employment service.

The FBI inquiry is to determine if fraud statutes have been violated.

Sources in the employment service, who asked not to be identified, have charged that top-level officials in the agency have ordered false job placement records to be made.

They claim records were falsified and that nearly 1,000 job placements claimed by the state agency are fraudulent.

Names and other information were obtained for the false placements, the sources alleged, from records maintained by the Comprehensive Economic Training Act (CETA) program in Oklahoma City.

CETA is a federal job training and placement program that attempts to place persons in public and private jobs.

The employment service has a full-time employe who works with the CETA program in Oklahoma City.

It can legitimately claim as job placements persons that have applied for jobs through the employment service.

Most of the allegations against the employment service involve a CETA summer youth program.

Walter Rapp, the chief administrator for the Oklahoma Employment Security Commission, denied that any commission employe had ever been instructed to falsify agency records. In fact, he said, employes are under specific orders to guard against errors in reporting agency activities at all times.

In addition, Rapp said, validation audits are made regularly by OESC personnel and the Labor Department.

"There is always the possibility of human error," he said, "but we feel we have an adequate system of checks and balances to keep erroneous information to a minimum."

He said the last Labor Department audit of OESC records showed the agency had an error rate far below the national average.

Both Rapp and OESC chairman John Bay Green, of Duncan, said an investigation would be welcomed.

A similar complaint was made against the employment service last year when Stephen A. Fletcher, an employment office worker in Norman, brought suit against the agency in District Court.

Fletcher claimed that he was transferred after the Norman office was ordered by "superiors" to file reports taking credit for job placements it hadn't made.

Joe Logan, head of the Employment Service division that includes Tulsa and Oklahoma City, said that an in-house investigation by the state agency did not turn up any wrong doing.

Fletcher dropped his suit, and his lawyer announced that a settlement had been reached.

Logan said Fletcher later resigned.

RECEIVED
FEB 1977
R. O. S.

Peoria Jnl-Star 11-12-80

Illinois Job Service Offers Free Help For Job Seekers

There are more than 800 private employment agencies in Illinois that charge fees for their services, and there's a public one that doesn't.

Job Service, a state agency with 100 offices throughout the state, offers skill evaluation and counseling for people seeking jobs in line with their qualifications.

"Many times, we've got the same jobs listed as do the places where you have to pay," says director John Gernon. "But we're free. And, like the other agencies, if we don't have a job for someone who comes to us for help, we'll start looking for one that's suitable."

Gernon said the office "has placed everyone from dishwashers at fast-food companies to registered nurses to mechanical electrical engineers."

If you decide to seek assistance from a private employment agency, Job Service recommends shopping around and checking with others looking for jobs. The state does not regulate fees, which are set at whatever level the market will bear.

Sheila Fitzgerald, a University of Illinois family economics specialist, says you are under no obligation if you don't accept a job offered. "So don't allow yourself to be pressured into accepting a position you don't really want or into paying a fee before the agency finds you a job.

"Also, find out what happens if the job doesn't work out. Some firms still hold you responsible for payment of the full fee while others work out a different arrangement, depending on how long you work." (OBVIOUSLY, EDITORIAL EXPOSURE

11% Rise In Construction Costs Forecast In

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ROBERT O. SNELLING, SR.
Chairman of the Board

October 27, 1981

Benson Goldstein
House Small Business Committee
Subcommittee on Small Business Problems
Rayburn Building Room B-363
Washington, D. C. 20515

Anne and I want to tell you how much we appreciate your time and interest during our recent visit to Washington. Your interest in House Bill HR 4738 is greatly appreciated, and we hope you will call on us for any further information you may need. Representative Paul Findley's office is also ready and willing to help with your questions.

I am enclosing some reference material, as per your request.

R. O. Snelling

ROS:sb

Karen Egan

Department of Public Welfare
Office of Income Maintenance
Bureau of Employment Programs

PEP Report for the Period of August 1 - 31, 1981

This report contains information for the month of August 1981, as well as cumulative information for the 1981-82 fiscal year. Plans are being made to include a chart reflective of monthly changes in activities in next month's report.

Page 6, the PEP Client Activity Report, is a combined report indicating, among other things, the unduplicated number of clients registered in each PEP County during the month. A comparison of this figure with the total placements in a given month will provide a clearer indication of activities and success of the PEP Units.

The CETA Special Grant Counties' activities are shown as a combined effort of these Units in the total PEP Program and should not be added in the reports of the other components.

The Employment Program Trainee authorized complement currently stands at 55. The limited amount of funds available this fiscal year has forced the reduction of the number of slots to 44. This month shows 38 of these slots filled. Efforts are continuing to find permanent, full-time jobs for those trainees who are nearing the end of the maximum of 12 months enrollment.

Period 7-1-81 to 8-31-81

PEP UNIT ACTIVITY SUMMARY

CUMULATIVE REPORT FOR FISCAL YEAR'S ACTIVITIES

CATEGORY	REFERRALS	NUMBER OF PLACEMENTS			CASH ASSISTANCE DISCONTINUED		CASH ASSISTANCE REDUCED	
	Number	Employment	Training	Total	No. Clients**	Monthly Amt. $	No. Clients**	Monthly Amt. $
PRIVATE EMPLOYMENT AGENCIES VOUCHERS	619	126		126	112	19,339.60	1	25.64
PEP DIRECT	10,468	1,316	152	1,468	2,255	361,084.25	93	6,610.94
OES CONTRACTS								
CETA	1,758	243	47	290	419	69,778.99	25	2,027.82
TOTAL	12,845	1,685	199	1,884	2,786	450,202.84	119	8,664.40

TOTAL WELFARE SAVINGS* ▶ $458,867.24

*Current statistics indicate that the average General Assistance client remains on the rolls for one year. The above savings are calculated for one month only, the month during which the activity took place, and are not cumulative. A projection can be made, therefore, that an annual savings of $5,506,406.88 will result from the first two months' activity.

**Of these figures, cash payments for 632 clients were discontinued, and cash payments for 5 clients were reduced, as a result of sanctions.

PEP - PRIVATE EMPLOYMENT AGENCIES (PEA) VOUCHERS Period: 8-1-81 to 8-31-81

County Board of Assistance	Date Started Partici-pation	Number of Referrals*	No. Placements			Public Assistance Terminated		Public Assistance Reduced		Welfare Savings (Combined Terminations & Reductions)
			Employ-ment	Train-ing	Total	No. Cli-ents	Amount $	No. Cli-ents	Amount	
1. Adams										
2. Allegheny	1-1-80	67	16		16	7	1204.00	-	-	1204.00
3. Armstrong										
4. Beaver										
5. Bedford										
6. Berks										
7. Blair	1-1-80	0					-		-	-
8. Bradford										
9. Bucks										
10. Butler	3-1-80	3	1		1		-		-	-
11. Cambria	3-1-80	2	1		1		-		-	-
12. Cameron										
13. Carbon										
14. Centre										
15. Chester										
16. Clarion										
17. Clearfield										
18. Clinton										
19. Columbia										
20. Crawford										
21. Cumberland										
22. Dauphin	2-1-80	9	3		3	3	516.00			516.00
23. Delaware	2-1-80	38			-		-			-
24. Elk										
25. Erie										
26. Fayette										
27. Forest										
28. Franklin										
29. Fulton										
30. Greene										
31. Huntingdon										
32. Indiana										
33. Jefferson										
34. Juniata										
35. Lackawanna										
36. Lancaster	1-1-80	0			-		-		-	-
37. Lawrence	2-1-80	2			-		-		-	-
38. Lebanon										
39. Lehigh	1-1-80	2	2		2		-		-	-
40. Luzerne	1-1-80	0			-		-		-	-
41. Lycoming	1-18-80	1			-		-		-	-
42. McKean										
43. Mercer										
44. Mifflin										
45. Monroe										
46. Montgomery										
47. Montour										
48. Northampton										
49. Northumberland										
50. Perry										
51. Philadelphia	1-18-80	122	49		49	47	8084.00			8084.00
52. Pike										
53. Potter										
54. Schuylkill										
55. Snyder										
56. Somerset										
57. Sullivan										
58. Susquehanna										
59. Tioga										
60. Union										
61. Venango										
62. Warren										
63. Washington										
64. Wayne										
65. Westmoreland										
66. Wyoming										
67. York	2-1-80	54	8		8	7	1230.60	1	25.64	1256.24
TOTALS	[redacted]	300	80		80	64	11034.60	1	25.64	11060.24

*These figures represent the number of vouchers (one per client) issued to clients during the current reporting month.

NOTE: Only East and Southeast Districts of Allegheny CAO, and Boulevard and West Districts of Philadelphia CAO, are participants in PEP-PEA.

PEP-DIRECT

Period: 8-1-81 to 8-31-81

County Board of Assistance	Date Started Participation	Number of Referrals*	No. Placements			Public Assistance Terminated		Public Assistance Reduced		Welfare Savings (Combined Terminations & Reductions)
			Employment	Training	Total	No. Clients	Amount $	No. Clients	Amount	
1. Adams										
2. Allegheny	8-1-80	54	25		24	30	5160.00			5160.00
3. Armstrong										
4. Beaver										
5. Bedford	5-1-80	5	15		15	20	2272.00			2272.00
6. Berks	11-1-79	83	4		4	5	819.00			819.00
7. Blair	1-1-80	22	62		62	65	8686.75	22	1140.64	9827.39
8. Bradford										
9. Bucks	11-1-79	44	21		21	87	12841.00			12841.00
10. Butler	3-1-80	107	27		27	53	8918.00	1	40.40	8958.40
11. Cambria	11-1-79	89	3	5	8	20	2313.20	2	173.00	2486.20
12. Cameron										
13. Carbon										
14. Centre										
15. Chester	3-1-80	59	9	1	10	18	2929.00			2929.00
16. Clarion										
17. Clearfield	1-15-80	205	66		66	89	20874.00			20874.00
18. Clinton										
19. Columbia										
20. Crawford	3-1-80	36	5		5	9	1548.00			1548.00
21. Cumberland										
22. Dauphin	2-1-80	779	32		32	34	5848.00			5848.00
23. Delaware	11-1-79	272	30	6	36	57	9478.60	2	242.20	9720.80
24. Elk										
25. Erie	7-1-80	145	33		33	36	5914.00	3	235.00	6149.00
26. Fayette	11-1-79	42	14	1	15	18	2257.00			2257.00
27. Forest										
28. Franklin	7-1-81	95	19	2	21	33	4432.00			4432.00
29. Fulton	5-1-80	11	3	1	4	7	684.00			684.00
30. Greene										
31. Huntingdon										
32. Indiana										
33. Jefferson										
34. Juniata										
35. Lackawanna	11-1-79	90	31		31	68	11307.00	1	40.00	11347.00
36. Lancaster	11-1-79	1606	68		68	134	21531.00	2	106.00	21637.00
37. Lawrence	11-1-79	73	14	1	15	17	2548.00			2548.00
38. Lebanon	5-1-81	215	5	92	97	23	3758.00			3758.00
39. Lehigh	1-1-80	7	2	2	4	6	1200.00	1	172.00	1372.00
40. Luzerne	11-1-79	93	95		95	113	20173.50			20173.50
41. Lycoming										
42. McKean										
43. Mercer										
44. Mifflin										
45. Monroe										
46. Montgomery	1-1-80	16			-	5	905.00			905.00
47. Montour										
48. Northampton	1-1-80	136	8		8	9	1808.80	1	267.87	2076.67
49. Northumberland	11-1-79	86	26		26	41	4611.92			4611.92
50. Perry										
51. Philadelphia	3-1-80	110	8	4	12	35	6020.00			6020.00
52. Pike										
53. Potter										
54. Schuylkill										
55. Snyder										
56. Somerset	5-1-80	15	12		12	10	1470.00	4	400.00	1870.00
57. Sullivan										
58. Susquehanna										
59. Tioga										
60. Union										
61. Venango										
62. Warren										
63. Washington	9-1-80	25	4		4	9	1476.00	1	66.20	1542.20
64. Wayne										
65. Westmoreland	7-1-81	93	18		18	19	3310.91			3310.91
66. Wyoming										
67. York	7-1-80	580	25	2	27	35	5930.20	1	143.40	6073.60
TOTALS		5193	684	117	801	1105	181,324.38	41	3026.71	184,051.59

*Figures in this column may be duplicate; i.e., a client may have been referred to an employment or training source more than once.

PEP - CETA SPECIAL GRANT

Period: 8-1-81 to 8-31-81

County Board of Assistance	Date Started Partici-pation	Number of Referrals*	No. Placements			Public Assistance Terminated		Public Assistance Reduced		Welfare Savings (Combined Terminations & Reductions)
			Employ-ment	Train-ing	Total	No. Cli-ents	Amount $	No. Cli-ents	Amount	
1. Adams										
2. Allegheny										
3. Armstrong										
4. Beaver										
5. Bedford										
6. Berks										
7. Blair										
8. Bradford										
9. Bucks										
10. Butler										
11. Cambria										
12. Cameron										
13. Carbon										
14. Centre										
15. Chester	3-1-80	38		2	2	1	181.00	1	20.00	201.00
16. Clarion										
17. Clearfield										
18. Clinton										
19. Columbia										
20. Crawford										
21. Cumberland										
22. Dauphin	3-1-80	12	1	1	2	2	344.00			344.00
23. Delaware										
24. Elk										
25. Erie	3-1-80	24	4		4	6	599.00			599.00
26. Fayette										
27. Forest										
28. Franklin										
29. Fulton										
30. Greene										
31. Huntingdon										
32. Indiana										
33. Jefferson										
34. Juniata										
35. Lackawanna										
36. Lancaster										
37. Lawrence										
38. Lebanon										
39. Lehigh										
40. Luzerne	3-1-80	63		11	11	11	1982.00	5	123.82	2105.82
41. Lycoming										
42. McKean										
43. Mercer										
44. Mifflin										
45. Monroe										
46. Montgomery										
47. Montour										
48. Northampton	3-1-80	93	9	1	10	22	3670.70			3670.70
49. Northumberland										
50. Perry										
51. Philadelphia										
52. Pike										
53. Potter										
54. Schuylkill										
55. Snyder										
56. Somerset										
57. Sullivan										
58. Susquehanna										
59. Tioga										
60. Union										
61. Venango										
62. Warren										
63. Washington	3-1-80	68	23	4	27	45	7253.80	3	280.40	7534.20
64. Wayne										
65. Westmoreland										
66. Wyoming										
67. York										
TOTALS	[redacted]	298	37	19	56	87	14030.50	9	424.22	14454.72

*Figures in this column may be duplicate; i.e., a client may have been referred to an employment or training source more than once.

PEP - CLIENT ACTIVITY REPORT

Period: 8-1-81 to 8-31-81

Number of Clients COUNTIES	Total Registered in PEP Unit	PEP Referral Actions*				Placed in Employment				Placed in Training				Cash Assistance Discontinued				Cash Assistance Reduced			
		Direct	PEA	CETA	Total	Direct	PEA	CETA	Total	Direct	PEA	CETA	Total	Place-ments	Sanc-tions	Others	Total	Place-ments	Sanc-tions	Others	Total
1. Adams																					
2. Allegheny	67	54	67		121	25	16		41				-	27	6	4	37				-
3. Armstrong																					
4. Beaver																					
5. Bedford	7	5			5	15			15				-	20			20				-
6. Berks	8	83			83	4			4				-	4	1		5				-
7. Blair	114	22			22	62			62				-	65			65	22			22
8. Bradford																					
9. Bucks	68	44			44	21			21				-	29	58		87				-
10. Butler	78	107	3		110	27	1		28				-	30	23		53		1		1
11. Cambria	44	89	2		91	3	1		4	5			5	20			20	2			2
12. Cameron																					
13. Carbon																					
14. Centre																					
15. Chester	58	59		38	97	9			9	2		1	3	14	5		19	1			1
16. Clarion																					
17. Clearfield	43	205			205	66			66				-	66	23		89				-
18. Clinton																					
19. Columbia																					
20. Crawford	34	36			36	5			5				-	4	4	1	9				-
21. Cumberland																					
22. Dauphin	123	779	9	12	800	32	3	1	36			1	1	35	2	2	39				-
23. Delaware	61	272	38		310	30			30	6			6	35	18	4	57	2			2
24. Elk																					
25. Erie	148	145		24	169	33		4	37				-	41	1		42	3			3
26. Fayette	42	42			42	14			14	1			1	18			18				-
27. Forest																					
28. Franklin	34	95			95	19			19	2			2	31	2		33				-
29. Fulton	0	11			11	3			3	1			1	7			7				-
30. Greene																					
31. Huntingdon																					
32 Indiana																					
33. Jefferson																					
34. Juniata																					
35. Lackawanna	45	90			90	31			31				-	50	18		68	1			1
36. Lancaster	199	1606			1606	68			68				-	91	43		134	2			2
37. Lawrence	36	73	2		75	14			14	1			1	17			17				-
38. Lebanon	107	215			215	5			5	92			92	2	17	4	23				-
39. Lehigh	9	7	2		9	2	2		4	2			2	2		4	6	1			1
40. Luzerne	156	93		63	156	95			95			11	11	106	18		124	5			5
41. Lycoming	1		1		1				-				-				-				-
42. McKean																					
43. Mercer																					
44. Mifflin																					
45. Monroe																					
46. Montgomery	0	16			16				-				-	4	1		5				-
47. Montour																					
48. Northampton	46	136		93	229	8		9	17			1	1	22	9		31	1			1
49. Northumberland	337	86			86	26			26				-	36	5		41				-
50. Perry																					
51. Philadelphia	118	110	122		232	8	49		57	4			4	53	27	2	82				-
52. Pike																					
53. Potter																					
54. Schuylkill																					
55. Snyder																					
56. Somerset	49	15			15	12			12				-	8	2		10	4			4
57. Sullivan																					
58. Susquehanna																					
59. Tioga																					
60. Union																					
61. Venango																					
62. Warren																					
63. Washington	47	25		68	93	4		23	27			4	4	32	19	3	54	1	2	1	4
64. Wayne																					
65. Westmoreland	93	93			93	18			18				-	18	1		19				-
66. Wyoming																					
67. York	93	580	54		634	25	8		33	2			2	33	9		42	2			2
TOTALS	2265	5193	300	298	5791	684	80	37	801	118		13	136	920	312	24	1256	47	3	1	51

*Figures in this column may be duplicate; i.e., a client may have been referred to an employment or training source more than once.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Saly - Rose
202-345-5044

MAY 11 1981

Dr. Robert O. Snelling, Sr.
International Headquarters - Snelling Plaza
4000 South Tamiami Trail
Sarasota, Florida 33581

Dear Dr. Snelling:

Thank you for your letter to the Director regarding the use of private sector employment services to find jobs for unemployment compensation and able-to-work welfare recipients. I believe your idea merits careful consideration as we examine alternate ways to put Americans back to work. I have asked the staff here to study the material you sent, as well as the analysis by Mathematica Policy Research of the Michigan experiment.

If you are aware of any other studies of the use of private employment agencies to place unemployment compensation claimants or recipients of income maintenance benefits that might be enlightening, please let me know.

I appreciate your providing the information on the California, Michigan, and Pennsylvania projects; please keep me apprised of your thoughts and any further developments in the ongoing Pennsylvania project.

Sincerely,

Donald W. Moran
Associate Director for Human
Resources, Veterans and Labor

cc: Honorable Andrew Lewis, Secretary of Transportation

Snelling and Snelling, Inc.
FORT SNELLING

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DR. ROBERT O. SNELLING, SR.
Chairman of the Board

June 5, 1981

Mr. Donald W. Moran
Associate Director for Human Resources
Veterans and Labor
Office of Management and Budget
Washington, D.C. 20503

Dear Don:

Anne and I want to thank you for your time and interest during our recent trip to Washington. We appreciate your making room for us in your busy schedule, and found our talk on the viability of jobs for the long term unemployment compensation and able-to-work welfare recipients very rewarding.

I'm enclosing a xerox of an excerpt from the Federal Register of 4-13-81, noting that the GAO and Department of Justice advise Federal agencies to consider contracting with private sources, such as collection agencies, to supplement Federal collection programs.

No doubt private collection agencies would aid greatly in reducing a problem that has now assumed enormous proportions; how to get people to pay the sums of money they owe the government. I'm sure enlisting private collection agencies to recover these sums would be well worth the comparatively modest percentage the agencies charge for this service.

Of course, this recommendation by the Justice Department and the GAO is of considerable interest since it would establish a precedent that might very well implement the Private Sector Employment Service Program I recently submitted to the Office of Management and Budget, and which you were gracious enough to review recently.

In line with your letter of May 11th suggesting I keep you apprised of further developments in the ongoing Pennsylvania Employables Program, a report is now being prepared. There have been some interesting adjustments in this program, and the program itself continues to be successful.

Please let me know if we can be of further service.

Sincerely,

Dr. Robert O. Snelling, Sr.
ROS:mc

MICHIGAN PRIVATE PLACEMENT PROJECT
PEA 1115A

Operated by: The Department of Social Services

Authorized under: 42 USCA 1315 and
MCLA 400.10

This demonstration project was to test the cost effectiveness of utilizing private employment agencies in placing aid to families with dependent children (AFDC) clients on a $204,000 grant from HEW.

Period: January, 1977 to April, 1977

As in each such case, public employees were not overjoyed with the prospect of being compared by the private sector. A part of the contract of each private employment service signed was a "gag rule" to stop them from making any information public about the plan.

The welfare people at first did not think the private agencies could place their AFDC recipients. When they saw it could work, the supply of applicants had dried up. Those applicants who were sent were advised not to take a job unless it paid a certain amount, since their benefits amounted to more than that. Others had no transportation and were referred to private agencies a great distance from their homes.

By March 11th, one private Employment Service had only been sent 47 people. Eight of these never showed up and seven had no transportation. Of the thirty that came to the office, eleven were refused based on unwillingness to accept job assignments, dress, etc. Of the nineteen remaining, six had been placed. Two of these refused to go to work on the jobs they were placed on. Two applicants already had jobs but were still collecting AFDC. Others told employers they didn't know why they had been sent since they didn't want to go to work. To date we have not received any figures from the state as to the effectiveness of the program. But we are sure these figures exist somewhere showing in detail, that in the opinion of the department personnel free enterprise could not do the job. We got an inkling of this when the head of the program said for statistical purposes they would count everyone referred to a private employment agency whether or not they showed up, or whether or not they were willing to go on an interview. Additionally, we were refused permission to sit in on the orientation given to the W.I.N. project people who were to refer the ADFC claimants to us.

There is no doubt in our minds, even from the limited statistics we have, that this program was highly successful and saved the state of Michigan a great deal of money. However, as had been the case with each one of this type of project or test, an attempt has been made to use these figures to show that such activities on the part of free enterprise were not cost effective.

PENNSYLVANIA EMPLOYABLES PROGRAM

Act 202 - Section 405.1

July 1976

This Act called for Public Assistance applicants, as an eligibility requirement, to register with private employment agencies who would be reimbursed on a contingency basis for placing them and who would be required to report to the State any such applicants who refused to take work so that those individuals could be removed from the rolls.

A demonstration project was implemented in a few selected areas by the Pennsylvania Department of Public Welfare in October, 1979.

It is no secret that the welfare department was not over-receptive at the prospect called for by this law.

You will note the law was passed in July, 1976 and was not implemented until October, 1979. This coming after the welfare department had been told they would be violating the law if they did not proceed. A letter inviting the private Employment Services was dated October 12, and not received by some Employment Services until the 15th or 16th , and it called for a response from them within 10 days from the date of the letter. Additionally, in an attempt to sandbag the test, the state's contract offered to the private employment services called for a $75 registration fee and a 10% placement fee, neither of which was desired or requested by the private sector.

This sad litany could be extended but these examples serve the purpose. Although the law clearly calls for a one year test, the progam was suspended in May, 1980.

Despite a more than three year lag on legislation to implementation and a short six months initial shakedown test period, this program has been an outstanding success, saving the state millions of dollars in cash assistance payments (unemployment compensation, welfare, etc).

In addition, these working individuals are now taxpayers and job creators through their increased purchasing power. Additionally, they are no longer causing the state and federal governments to expend manpower and money on them over and above the actual cash assistance they were formerly receiving.

A small segment of the private sector of the Employment Service Profession has done an outstanding job of putting these unemployed individuals back to work. They could have done an even better job had more of them been given the opportunity to help and had they been given more individuals to place. They only saw 900 individuals out of a total of 14,794 which were processed by the welfare people for this program but not sent on to the private sector. This was a miserly 6% of these people, however, they placed 88 people out of the 900 or approximately 10% of them. For this they were paid approximately $62,000 which, in turn, they used to pay salaries, rent, telephone, taxes, etc. The state saved in excess of $176,000 in cash assistance payments which is a return on investment of 184%. !!

However, this ROI could even be doubled or tripled depending on the number of people taken from the rolls because they refused to go on interviews or accept jobs. The state claims that for every two persons placed at least one was sanctioned (removed). That would be a minimum for the private sector of 29 persons (annualized savings $58,000). However, the state counted all such removals to its own credit (752 out of 2271 total placements) even though the private sector was responsible for a high percentage of those removals.

The legislature had authorized over $600,000 to pay the private sector. To date approximately $60,000 or 10% has been used due to the late start, the lack of applicants being referred and the small number of Employment Services being utilized.

The state, in an attempt to discredit the test, claims to have placed 1,251 individuals out of 12,587 that they saw or approximately 10% and suggests that their cost of placement may be lower. Whether or not we accept their numbers (placements or cost) is not the question. The plain fact is that all of the millions of unemployed and able to work welfare recipients that any placement source that can give the state and/or the federal government a 200+% return on its investment cannot be overlooked. The private sector of the Employment Service Profession must be utilized in the battle against demeaning and demoralizing unemployment.

CALIFORNIA PROJECT

"Private Employment Agency Project II"

Conducted by: State of California .

Employment Development Department

Health and Welfare Agency

Under grant from: U.S. Office of Economic Opportunity Grant #CG9831 A/1

To test the feasibility of using private agencies as a supplemental resource to place the disadvantaged which were welfare mothers and unemployment insurance claimants.

The results were dramatic. 104 Employment Services saw 1,138 applicants, sent them on 1,620 interviews for actual jobs, placed 29% of them in two months.

Of the 311 placed, 184 lasted 90 days or more and 127 lasted 180 days or more.

The savings far outweighed the contingency charges made by the private sector which averaged $313 for U.I. claimants and $214 for welfare mothers.

At that time the average A.F.D.C. - F.G. payments were $231 per month and the average U.I. benefits were $285 per month.

The gross savings in these payments were in excess of $328,000 while the cost was only $78,000 paid out to the private sector. This gave a net savings of $250,000 or a return of $3 for every $1 invested.

FORT SNELLING
COURIER

Volume XXIII Number 6 March 21, 1980

PEC Jan Hufnell Finding Jobs For Those On Welfare

Jan Hufnell

Two people formerly on the welfare rolls have been placed in good jobs by Jan Hufnell, and a third is being interviewed with good prospects for placement. All of this has transpired in one month.

Jan and her husband, Bill, bought the Snelling and Snelling franchise located in the Public Ledger Building, 6th & Chestnut Streets, in Philadelphia in August, 1978. Bill is the manager and Jan works both AST and SOC desks.

"Bob Snelling has been encouraging us to work with the Pennsylvania Employment Program (PEP), and get people off welfare and into jobs," Jan said. "We decided to give it a try.

"The County Public Assistance Office sends us welfare recipients who are willing to work. We screen them and get them to make a commitment to us — they must promise to give a company two years, to be punctual, work hard, be a good employee.

"It's a tough process to turn some of them around. The big problem is lack of motivation.

"However, it's a good deal because everybody benefits," Jan maintains. "We are offering the company a bargain because the State pays the service charge. That's particularly good in this area where 94% of the charges are paid by the employer. Furthermore, through the Targeted Jobs Tax Credit, the employer can deduct off the top of

(Continued on Page 3)

Laurel Motal

Receptionist Of The Month

Our Receptionist of the Month for March, 1980, is Laurel Motal of the Houston, Texas, office at Westheimer Road.

Operations Manager Marion M. Rosenwald relates, "The Westheimer office of Houston Snelling and Snelling is convinced that Laurel is its biggest asset. She has a lovely, clear phone voice; she is always gracious and calm; she is always up-to-date, yet her efficiency is such that no one has ever seen her rush. And, of course, she always looks lovely — runs in hose or spots simply don't happen to Laurel.

"Her open friendliness is probably due to her small-town background in El Campo, Texas. Her astounding neatness and record-keeping ability may be attributed to her education at S. W. Texas State University. Her ability to handle people is a result of the two years she spent teaching.

"We are fortunate that she wanted to get into the business world and move to a large city, and that a good Counsellor referred her to us rather than to one of our employers. She is completely capable of functioning as an Administrative Assistant, and is instrumental in keeping a busy office running smoothly. Her almost-three years with us have spoiled us and we hope she continues to do so."

The USES and The JSECs

By Dr. Robert O. Snelling, Sr.

This article could be headed, "Everything You Need To Know — and Wished Had Never Happened — About the Current USES Employers Program."

We'd like you to have this information at your fingertips so you may discuss it knowledgeably with your many contacts. It directly affects our profession and the employees with whom we deal.

The United States Employment Service (USES) came into being with the passage of the Wagner-Peyser Act in 1932 during the Great Depression. Over 12,000,000 people, or 25% of the work-force, were unemployed and the purpose of the USES, then and *now*, was to find jobs for the *unemployed*.

Today they have gone far beyond their original mandate, and are using every means possible to influence the nation's employers to deal exclusively with them. That puts the USES, and its State Job Services, in direct competition with us, and the government is not supposed to compete with private enterprise.

The USES has created the JSECs, the Job Service Employer Committees. In their own words, the USES states that these Committees "were established to enhance your communication and involvement with local Job Services. JSECs are directed toward giving you improved and more personalized employment services, with a view to encourage you to use these services often."

The USES is telling employers, "You've already paid for our service, so why not use it." Of course, it's not a "free" service; it's already been paid for through tax dollars. And if everyone turns to their service, our taxes will have to go up to support those increased services.

If all of the 14,000,000 people who change jobs each year were to utilize the State Job Services, they would literally go under. They could not handle the crush of people at their doors, and they certainly could not give the service to the unemployed and the disadvantaged that they should be giving.

THE WORLD'S LARGEST EMPLOYMENT SERVICE

PEC Jan Hufnell . . .

(Continued from Page 1)

corporate taxes, up to $3,000 for the first year's wages and up to $1,500 the second year. This is a good incentive for employers to cooperate with us.

"The State benefits by getting people off welfare, with all the incumbent expense, and into productive jobs where they are taxpaying workers."

Jan thinks that those who benefit most of all are the applicants themselves, and illustrates her point by describing her two successful placements.

"The first man had been on welfare for 10 months and was really down. I worked to get him self-motivated and accomplished a complete turnaround. Even the welfare people were amazed when he paid them a visit. He had on a new shirt and perky tie.

"'What's happened to him?' they asked.

"He's had five job interviews and five job offers, and he's got his self-respect back," I told them.

"I placed him in a $10,000 a year job as a warehouse person, and the company says he should work into a supervisory position in a year.

"The second man was quiet, completely unmotivated. I established a rapport with him, and we made a commitment to each other.

"You work with me and I'll get you a job," I said.

"He wanted to work in the linen department of a hospital, and I placed him through laundry association contacts at $4.75 per hour, excellent benefits, and the opportunity to earn $6 per hour in a year.

"This man, who has a wife and two children, came out of a very depressed state into a contented person. He wrote me the following letter."

Dear Mrs. Hufnell,

"In a world where greed and deception are all too common, it is hard to find any people sincerely dedicated to helping others, without possessing some ulterior motive. You definitely impressed me as being one of those rare people.

"In the past I must have gone to more than half-a-dozen employment agencies, and they all left me cold. They made me feel more like a number waiting to be placed than a person waiting to be placed. The one that did place me several years ago certainly never gave me my money's worth as I told you in person.

"You are the first really genuine employment agent I ever met - congratulations! I loved working with you every step along the way to obtain my job. It was a sheer pleasure.

"Your sincere interest in me, along with the *professional* advice and hard effort you put forth, clearly demonstrates that here is a person who really loves her work and the people she serves, and not just the money. Even my wife remarked that you are the only employment agent who cared.

"You definitely are a credit both to your field of occupation and the agency you represent. And from my brief discussions with your husband, I'm sure he possesses the same outstanding qualities. Be assured that should I meet anyone looking for a career, it will be my pleasure to refer them to you. From a very happy client." R. K.

PEC Diana Marks Sets El Paso Record

Diana Marks

Diana Marks has an unbroken string of 20 National awards, "with no end in sight," says her manager Alice King. That's an award for top production every month since June, 1978.

Diana had joined Jim King's El Paso office on Stanton Street in September, 1977, after registering as an applicant. She had been a housewife, done a lot of volunteer work, modelling, interior design, and assisted as hostess in her husband's restaurant.

She found her new career in counselling to be challenging and interesting, but she did not catch fire as a top producer until June, 1978, when Alice King stepped into the manager's job in her husband Jim's office.

"Diana's 20 consecutive awards is a record here in El Paso," Alice said. "When she made it an even dozen, we presented her with a plaque called, 'The Mark of Distinction Award.'

"She is truly a professional, and a credit to our El Paso operation and the Snelling and Snelling system. We have come a long way together, and that's what adds poignancy to this story.

"I made an incredible mistake in calculating Diana's 1978-79 fiscal year net receipts, because I am an absolutely lousy mathematician. She actually entered the Honor Circle in May, 1979, with a cash-in of $53,901.

"When I told her about my error, she said that just knowing within herself that she had made it was all that mattered. But she missed all the festivities in Dallas, missed the honor of receiving her award and the attendant recognition.

"Well, we can't go back, but Diana and her husband are my guests at the Honor Circle banquet this year because she is well on her way to making it — the second time."

Diana says that Alice feels much worse about this than she does. "I'm an achiever," she explains, "my real satisfaction is in helping people find jobs. To build a rapport with applicants by extending myself to uncover their true aspirations and then to fulfill them with placements in their chosen work is a richly rewarding experience for me."

Cash-In of $10,000 In First Month

Claudia Miller

New PEC Claudia Miller had cash-in of $10,274 and billings of $11,080 her first full month on the job.

Claudia joined the Pensacola, Florida, office on January 14, 1980, and just missed winning a Bronze award during the last two weeks of January. She earned a Platinum, with plenty to spare, in February.

She previously worked in retail sales for a local furniture company and, prior to that, sold cars for an automobile dealership who stated she was "the best they ever had."

Claudia came in to the Pensacola office as an applicant, and former owner and manager Bob Bennett spotted her potential as a PEC and recommended her employment to new owner and manager Dudley Miller.

"She has an outstanding phone personality and excellent voice," Dudley Miller says, "and, of course, superior sales ability. She goes out of her way to get to know prospective employers and where the jobs are, and is constantly developing new job sources for applicants. She has already spoken to a group at Pensacola Jr. College."

Wall St. Journal 7/17/81

Business Slow to Hire From CETA, Frustrating 'Reemployment' Plans

By Joann S. Lublin
Staff Reporter of The Wall Street Journal

A newspaper advertisement recently exhorted New Jersey businesses to hire 16,000 workers losing public-service jobs because of Reagan budget cuts. "If you have jobs available, stand up and be counted," the ad's bold type blared.

Result: A total of 18 employers offered a mere 20 job leads. So it is going in the strenuous effort of the Labor Department to find jobs for workers being cut loose, the workers whose wages have been subsidized through the Comprehensive Employment and Training Act. The private sector has been notably slow to come to the rescue. Generally high unemployment, the participants' lack of marketable skills and CETA's image as a "make-work employment agency" for the chronically unemployed all seem to be factors in that reluctance.

Funds for subsidizing CETA jobs are being eliminated by Sept. 30. By that time, no more than 20% of the 306,000 CETA workers will have found private employment, Labor Department officials predict.

Other Useful Work

A majority of CETA jobholders affected by elimination of the $4 billion jobs program (the "training" portion of the act continues in force) simply are switching to other public payrolls or forms of public support. Some of them—nearly 26,000 by recent count—have moved into the CETA training program, studying in such fields as typing, dog grooming and automobile repair, hoping to land private jobs. Some furloughed workers are drawing unemployment insurance. And some now hold unsubsidized jobs in the city or state agencies they worked for under CETA, typically in such jobs as street sweepers or file clerks.

Last spring, when the CETA cutbacks began, Labor Secretary Raymond Donovan enlisted community and business groups in the effort to move CETA workers into other jobs quickly—a move seen as an early test of the Reagan administration's reliance on business cooperation to help combat long-term unemployment.

The results in the private sector so far haven't been good. "This darn reemployment effort isn't the perfect example of our efforts to get (jobless) people into the private sector," says Albert Angrisani, Assistant Secretary of Labor for employment and training. "It's just a hodgepodge and a mess, and I'll be glad when it's over."

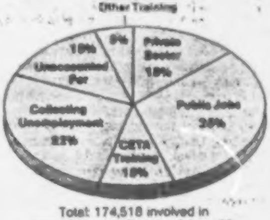
Axing the much-criticized CETA program may not ease the federal budget squeeze as much as was hoped. Income-tax revenues will fall as some CETA participants stop working, and many will draw jobless or welfare benefits, says Robert Cook, a Princeton University economist. He notes that the Labor Department itself has set aside $245 million for unemployment compensation for CETA workers.

The CETA worker who moves into a federal training program only takes the place of some other hard-core poor person, says Stephen Cain, employment services director for the U.S. Conference of Mayors. The displaced individual "is costing the city or state money, in welfare or unemployment insurance," he says.

Many local governments are retaining their CETA workers, at their own expense. Mr. Angrisani thinks that proves something. "If the public sector ... chooses to keep them on," he says, "they are obviously performing a needed function," even a "revenue-producing one—meter reading." New York City will spend $78 million to retain about 4,300 of its 6,537 CETA employes.

The Labor Department drive to help CETA workers has included special job-hunting training and job referrals by U.S. Employment Service offices, along with the ad campaigns and the pleas to business. But the extra effort hasn't made much difference. In San Francisco, for instance, about 22% of the 946 people cut from CETA payrolls have gotten private-sector jobs—about the same ratio as was registered by CETA jobholders who left in previous years.

Where Laid-Off CETA Workers Went



Total 174,518 involved in reemployment effort as of June 30.

Source Dept of Labor

Many public-service workers "didn't fit the needs of their private economy," says Eunice Elton, San Francisco's CETA administrator, who adds that the reemployment push "just hasn't caught on as the thing to do" among private employers.

In New Jersey, the troubled economy has hurt placement efforts by the National Alliance of Business and a group of local CETA administrators, which ran the newspaper ads. The business group sponsored a job fair in April at which 40 concerns screened 1,000 individuals. Only 20 landed jobs.

"There are many companies that have people who are laid off," and those firms won't "hire anyone until they put those people back to work," says William Short, the alliance's regional executive.

Chicago Mayor Jane Byrne met four times with 80 large employers to solicit job referrals, and 40 city personnel department staffers ran a reemployment center this summer for 5,000 CETA participants. "We were shooting to get a third to 40% placed in the private sector," says Chicago personnel commissioner Charles Pounian. "It will be more like 10% to 15%." The main obstacle, he explains, is that the backgrounds of most CETA employes don't match "the vacancies in the private sector—computer, word processing and secretarial skills."

J. Foster Fluetsch, a Stockton, Calif., savings-and-loan president who is hiring 100 CETA workers as tellers and clerks, tried unsuccessfully to persuade 100 other businesses to do the same. Mr. Fluetsch, who heads the State Savings & Loan Association, says he met resistance because the CETA program "didn't have a good reputation." Many executives' attitude "about my hiring these people was, 'Oh my gosh, who would be so dumb as to do a thing like that?' " he recounts. Yet only two of the first 50 CETA participants the S&L hired didn't work out, Mr. Fluetsch says, "which is a much better ratio than we've experienced in the past for entrance-level people."

Some people lopped from the CETA rolls complain that the reemployment effort has done them little good. John Tellefson, 34, lost his job last spring as a writer of grant applications for a Salina, Kan., veterans group. Since then, he says, local CETA officials have sent him to just one job interview.

On his own, the college-trained chemist has applied to be everything from a teacher to a motel maid in Salina. Mr. Tellefson wished the federal government would give him "some relocation assistance" so he could look for work "in a more prosperous city, like Wichita," 90 miles away. However, he concedes that the Labor Department "actually is helpless" to place him because "I have a spotty work record and my experience simply isn't very impressive."

Ritual Visits

Preston Goings, a former CETA-paid job trainer in Baltimore, says the placement assistance simply means "they make us come into the (state) employment office once a week; it's a joke because they don't have many jobs anyway." Or the positions pay less than the $280 a week he earned under CETA. "When it comes time for me to go to work, I'm going to find a job," Mr. Goings says. "They aren't going to find me a job." For now, he is "making out okay" living on jobless insurance while taking a course in real-estate selling.

Mr. Angrisani suspects there are many people who view the program's elimination as "a great chance to collect unemployment insurance." But while their reluctance to seek work probably has crimped the reemployment effort, the Labor Department official believes the special push will pay off in other ways. The Reagan administration is devising a new strategy against long-term joblessness, and Mr. Angrisani says he has learned "it won't work" without "better incentives" for private employers to hire the chronically unemployed.

HOW WILL THE OPERATION OF THE USES AND STATE JOB SERVICES BE AFFECTED BY A 25% BUDGET TRANSFER?

Undoubtedly there will be a realignment of USES and Job Service duties and priorities. One outcome could be a reduction, if not elimination, of funds spent on advertising in newspapers, Yellow Pages, radio and television, direct mail, etc. This money could be applied to retaining qualified personnel. Curtailment of management-level recruiting, and interviewing and screening of job applicants for the employer at the employer's place of business, the reduction of paperwork and like procedures, would allow for further savings to be applied to USES operations.

WILL THE HARD-TO-PLACE (LAST HIRED, FIRST FIRED) BE HELPED?

Test cases in California, Michigan and Pennsylvania have shown good-to-excellent results. In the latest Pennsylvania Employables Program Report (enclosed) the private sector employment service participating in this program placed 27% of referrals; an average of 20% were placed in July and August. Private employment services were paid $100,000, while savings to the State were $250,000.

WILL THERE BE AN OPPORTUNITY FOR FAVORITISM AMONG PRIVATE SECTOR EMPLOYMENT SERVICES PARTICIPATING IN THE PROGRAM?

Unemployment compensation recipients and others being referred to the private sector of the employment service profession will be given a list of private employment service offices in their county, city, or local vicinity, and will choose from these.

SHOULD THE PRIVATE SECTOR EMPLOYMENT SERVICES PARTICIPATING IN THE PROGRAM GIVE A SPECIAL RATE OR DISCOUNT TO THE GOVERNMENT?

An upper limit on service charges has been described in House Bill HR 4738 that is both reasonable to the private sector and protective of the government. Placement of unemployment compensation recipients and others is essentially not an easy undertaking; private employment services should not be expected to take less than their usual service charges, especially when finding jobs for these applicants will result in considerable savings to the Government.

(The maximum service charges are: 1% per thousand to a maximum of 25%. For example, an individual placed at $7,000 per year would require a service charge of $495 [7% of $7,000]. If placed at $9,000 a year it would be 9% of $9,000 or $810.)

In Pennsylvania, private employment services participating in the PEP program were offered $75 for each individual they 'counseled' whether or not that individual was ever placed in a job. They unanimously rejected this offer, preferring to be paid only when the applicant was found employment.

The livelihood of the private employment services depend on referrals from satisfied jobseekers and client companies. They are obligated therefore to work in an ethical and satisfactory manner.

CAN THE PRIVATE SECTOR HANDLE 9 MILLION UNEMPLOYMENT COMPENSATION RECIPIENTS?

If just 25% of the private employment service offices participate in the Private Sector Employment Service Program the number of job offices available to the nation's unemployed will have been doubled. The number of placement counselors will have been tripled, approximately, since in the private sector nearly everyone involved is in a placement capacity.

The private sector has the capacity and the expansion potential to handle an added load, not being subject to procedural delays, authorizations and paperwork as found in government agencies.

Processing of the job applicant in the private sector is more efficient because the private employment service offices do not specialize in counseling sessions, special group studies, evaluations and liasons, organization of community support agencies or employer visitations. All interviewing and consultations are geared for one thing - finding the applicant a job promptly.

IS THE USES/JOB SERVICE PLACEMENT ACTIVITY MORE COST-EFFECTIVE THAN PLACEMENTS BY THE PRIVATE SECTOR?

The private sector would be pleased to provide a comparison of our per capita cost placement figures, which are demonstrably accurate, with that of the USES, if the USES figures can clearly and accurately be determined by anyone.

Until 1979, USES figures for budgetary requirements were based on "transactions," which included counseling, interviews, numbers of job applicants sent on interviews with or without resulting job placement, etc. Budgetary allocations are still based on formulae for these years. Placements are now counted in three ways: Those lasting 3 days, called temporary, equivalent to private sector temporary help services. Two categories are called permanent: those from 3 to 150 days, and those over 150 days. These definitions are based on the Job Service interviewers' assessment of the length of employment.

TO WHAT EXTENT WILL THE PRIVATE SECTOR REQUIRE MANAGEMENT ASSISTANCE, FORMS, PROCEDURES INSTRUCTION, ETC. FROM THE GOVERNMENT?

In pilot programs in California, Michigan and Pennsylvania, paperwork was kept to a minimum. A simple voucher system, issued by the local USES office, is suggested.

Time is of the essence. We face a national emergency with an unemployment rate at 8% and many state unemployment funds bankrupted. House Bill HR 4738 needs to be effected swiftly in order to put the unemployed back to work.

STATEMENT OF ROBERT O. SNELLING, SR., PRESIDENT AND CHAIRMAN OF THE BOARD, SNELLING & SNELLING, INC.

Mr. Chairman and subcommittee members, I would like to address myself today to the following concerns: the rising rate of unemployment and the suffering it brings both to individual citizens and to the Nation, and the failure of government employment services to deal with it, even at enormous cost to the taxpayer.

However, I do not want to dwell on the negative. I do have a viable alternative to the continuing prospect of even more government programs applied to the unemployment problem and even more government spending.

On October 14, 1981, Representative Paul Findley of Illinois filed a bill in the House of Representatives, a copy of which is enclosed with my written testimony submitted to this committee. This bill, HR 4738, proposes the adoption of legislation to amend the Wagner-Peyser Act, which would require the State employment offices to use a portion of their existing budget to utilize the private sector of the employment service profession to locate jobs for the unemployed.

I am also submitting for the committee's inspection the article "The Great Manpower Grab," by the late Representative Frank T. Bow, published in 1964 in the Reader's Digest, which is a prophetic examination of the expansion of the United States Employment Service, and corruption of its programs in light of its original mandate - to find jobs for the unemployed - under the Wagner-Peyser Act of 1933. Since Representative Bow wrote "The Great Manpower Grab" the state employment offices administered by the USES have grown from 1900 to 2800, or nearly 50%. The USES annual budget has increased from 200 million dollars to 1.2 billion dollars (including 400 million for CETA placements).

Also attached to my written testimony for submission to the permanent record of this committee is a report from three city/county areas in California which have turned to private sector employment services to place CETA workers and rehabilitated city employees even though United States Employment Service/ State Job offices are available to them, because the local government agencies have found the private employment service profession can find jobs for people better and faster. Also, pilot programs in California, in Michigan and currently in Pennsylvania have used and are using private sector employment services with great success to find jobs for able-to-work welfare people and others on public assistance.

This is not a new idea - the Federal government from time to time over the years has urged greater use of the private sector, but has rarely done so. Instead, there have been laws passed to expand government agencies and departments at tremendous cost, delivering generally inadequate services that could better be supplied by the private sector.

The private employment services in the United States face a unique situation in that the Federal/State employment system has been expanding into management and professional level recruitment, opening offices in affluent suburbs to recruit highly skilled employed people, and advertising - often with a budget that is beyond most private employment services - to constantly remind the public that, as a government service, "there is never a fee." In addition, laws passed by Congress during the past decade or so virtually assures government dominance of the employment field by, for example, requiring any company with Federal contracts in excess of $2,500 to list all jobs with the USES/Job Service offices. Even though in many cases the chances of that employer finding specifically qualified applicants (such as computer analysts or engineers) through the USES is practically nil.

The continuing abuses, and poor performance of the United States Employment Service have not gone unnoticed. Through the years there have been indictments, criticisms and scandals, with the needy unemployed often to the fore with their complaints. The attached report from the State of California Health and Welfare Agency (1975) testifies to the dissatisfaction of employers.

The report of the United States General Accounting Office (1976) confirms many complaints, and finds a few extra. The sum of both these documents say the USES does a poor job of placing people, and many employers are reluctant to use it.

In contrast to this, the private sector employment services have over ten thousand offices throughout the nation, many of them in locations not served by the USES, with fifty thousand highly trained professional employment counselors who have found jobs for millions of job seekers. This success is based on the profession's ability to teach others how to put people to work and motivate them to do it quickly, without excessive cost, and in large numbers. In addition, because of their intimate knowledge of client companies, private sector employment services are able to create a job opening where none existed. Let me explain this:

In private sector employment service offices, 40% of placements occur in positions that were not listed with that office at the time the individual applied. One half of this group are placed in jobs that did not exist with the client company at the time the contact was made. This is due, in the main, to employers' confidence in the ability of the private sector employment services to recommend the right people to them. But it is also indicative of an interesting fact about the private sector employment services: they can and do generate jobs.

The main reason is that employers are encouraged to create an opening for a special person who is now available, based on the rationale that the particular skill may not be available in six months or a year when they may be looking. In many cases there are employers who have concluded they cannot find the right person for a position and have stopped looking. These things happen far more commonly in the business world than is generally known, but the professionals, the private sector employment services, have been aware of them for years, and know these jobs can be created when they have a good job candidate. The professional employment counselor actively canvasses the job market and client companies through "action calls" on the telephone to find the right job for their applicant (when they do not have a position for them in their files).

The professional employment service counselor is anxious to present the job candidate as one an employer would want. Private employment counselors interview every applicant, they know how to counsel and guide the job seeker, and will offer expert advice on how to dress for the job interview, how to act, how to answer questions, how to win the interview - in other words, how to get the job! No job applicant is sent to a company unannounced or without an appointment, so the employer does not have job candidates who have arrived at inconvenient times and who must be scheduled to return at a later date. Professional employment counselors follow up with employers and applicants to overcome any problems, and they work diligently to see both parties are satisfied even after the placement.

In 10,000 private employment offices throughout America, with 50,000 trained and experienced employment counselors, more than 2 million job seekers were found jobs this past year. However, as in most areas of employment, sometimes placements do not work out. Either the employer or the employee may want to terminate a position within a fairly short time. The private sector employment service will guarantee the placement for a reasonable period. While these guarantees vary from state to state, the Findley bill calls for a 100-day guarantee. If a position lasts less than a hundred days the private employment services will be required to return to the state 1% of the service charge for each day not worked. For instance, if either the employer or the employee terminates the employment, with or without cause, within 15 days the private employment service would refund 85% of the service charge. If the employee had worked 50 days the refund would be 50% of the service charge. This guarantees the state a fair return on investment due to savings of unemployment compensation payments.

Because they are private enterprises, normal business competition keeps private employment services' placement charges competitive. Service charges vary from state to state, city to city and even area to area; House Bill HR 4738 proposes each private employment service use their regular published charges, but not to exceed the maximums provided in the bill.

The savings in government expenditures which as a nation we are all very much concerned with now, are dramatic when the unemployed can quickly be put back to work. In the last six months of the Pennsylvania Employables Program the State of Pennsylvania paid out $300,000 to the private sector employment services and was able to save over 1.5 million dollars in public assistance funds. On a national basis and using the same ratio, the projected savings in unemployment benefits alone would be approximately $2 billion a year. A recent AFL-CIO report states that for every 1% reduction in unemployment the Federal government would save 25 to 30 billion dollars annually.

It's safe to say the use of the private sector employment services to reduce the number of unemployed will not increase spending, will not necessitate any investment in additional offices or personnel, will save the nation billions of dollars, and has been proven effective in pilot programs. Last but not least, it will help restore dignity and a sense of identity to many unemployed. In the words of an inner city youth: "Without a job I am nobody, with a job I am somebody."

With over 8% of our job force unemployed today, the USES/Job Service must be given a new mandate. With the proposed amendment to the Wagner-Peyser Act the number one priority for the USES would again become finding jobs for the unemployed. Employed persons would no longer be within the purview of the State Job Services, nor would running personnel offices and interview desks for favored employers under the GAMOT directive. Money saved on advertising would be better utilized in tackling the problems of placing the underskilled and underemployed of the inner city.

CETA can also benefit from utilizing the services of the USES/Job Service and the private employment services as indicated in some programs in California (see attached). Better employment would enhance the further allocations of funds for the training areas of CETA.

Abraham Lincoln once said: "The government should only do for the people what the people cannot do for themselves." We must free up America's dynamism and ability to grow, and create new opportunities for people who need to work and be part of our productive society.

Snelling and Snelling, Inc.

FORT SNELLING

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MAGGIE DAVIS
DIRECTOR
CORPORATE PUBLIC RELATIONS

November 4, 1981

Mr. Benson Goldstein
Subcommittee on Tax Access to Equity Capital
and Business Opportunities
House Small Business Committee
2361 RHOB
Washington, D.C. 20515

Dear Benson Goldstein:

This study by the California Health and Welfare Agency of the Department of Human Resources on employer evaluations of the State Job Service (here called Employment Development Department) shows, I think, why finding jobs for the unemployed remains a problem.

The main complaints are that the state job service itself seemed to lack the professional know-how to motivate its job applicants, and as a consequence they were not very attractive to would-be employers.

I am also attaching a breakdown and the original GAO report citing the lack of success by government agencies to deal with unemployment.

Bob Snelling will return from the National Association of Personnel Consultants in Dallas on Monday; I know he will want to return your call.

Sincerely,

Maggie Davis

Maggie Davis

cc: ROS
AMS
#3
#4

November 3, 1981

Robin Rushton
Office of Senator Paula Hawkins
1327 DSOB
Washington, D.C. 20510

Dear Robin:

Re your request for Senator Hawkins's staff to have more employment/unemployment material submitted:

The State of California, which instituted one of the first programs to utilize the private sector employment services in 1973 (Private Employment Agency Project II) did a study two years later on employers' attitudes toward the State job service, here called the Employment Development Department (EDD).

The finding, as stated in the Executive Summary on Page 1, indicated "the Employment Development Department (EDD) does not have a favorable image with the employer community."

Inherent in the report is a picture of a State/Federal agency struggling to compete with the private sector and not doing it well at all.

It should be noted that while 98% of the USES budget comes from Unemployment Compensation funds paid by employers, when the State has bankrupted its UC funds (as happened in 25 states for a total of over $5 billion last year), it is the State which must borrow money from the general fund of the Treasury.[*] The argument that the USES does not cost the taxpayer anything is not, therefore, valid.

Best,

Maggie

Maggie Davis

CC: Bob Guttman

[*] There is currently a total of $12,859,463,009.16 owed to the general fund of the Treasury by the Unemployment Trust Fund.

EMPLOYMENT SERVICES BOARD SURVEY: Employer Attitudes Toward Employment Development Department (EDD)

State of California, 1975
Health and Welfare Agency
Department of Human Resources

Questionnaires mailed to 21,000 employers randomly selected from Unemployment Insurance tax records. Response rate: approx. 50%

Questionnaire designed by Employment Services Board, and pretested on 150 employers. (See Executive Summary, attached)

Comments on state placement system by employers, page 12 (Excerpt):

> Large employers who evidenced an unfavorable stand toward EDD placement services tended to divide their basis of criticism between the screening skills of EDD staff, and the characteristics of the applicants who report to them. Employers who were critical of screening skills recommended that interviewers consider more than applicant skills in their selection. They suggest that personal characteristics be taken into account. They sometimes attributed their lack of screening to a goal of moving people off Unemployment Insurance or Welfare Benefit rolls. The most typical response (64% of the unfavorable employers who wrote comments) stated, in effect, that the service itself was somewhat unsatisfactory, but limited in its effectiveness to provide qualified and motivated applicants who were willing or able to comply with employers' expectations.
>
> Some employers criticized the EDD placements system as a factor which hindered its effectiveness.
>
> Some of the comments of major market employers who rated EDD's effectiveness as unsatisfactory were as follows:
>
> "It seems to be a people mill, with little or no counseling on the Department's part, so that applicants end up just looking for a job, not a position or a career. Companies don't want to merely fill a vacancy, but want long term contributors. More appreciation for the employers' needs rather than the Department's needs to move people out of employment lines is needed."
>
> "I do not wish to sound as though I am making a blanket condemnation of the Department's services. There have been isolated individuals who have been helful and appeared to be seriously interested in being of assistance. The majority appear to be normal Civil Servants who are putting in their time on the Roman Dole and prefer not to be bothered. Therefore the majority of my recruiting of personnel has to be newspaper ads, private agencies and other media."

EMPLOYMENT SERVICES BOARD SURVEY, cont.

"If the Department was more effective we could eliminate agencies. Somehow the Department has to reach prospective applicants and take advantage of the fact that they have the same opportunity to place an individual as an agency, but yet the Department cannot fulfill our requirements and agencies can."

"EDD is concerned with 'processing' applicants and not in filling job orders. The size of the local office has increased to the point where bureaucratic confusion renders them ineffective. It's too bad because they could and should be a primary source of referrals."

"The present system eliminates the personal contract we once enjoyed when placement personnel had a good understanding of job requirements and the qualifications we required of an applicant. The new system provides us with lots of people to talk to but who become disappointed or discouraged because they are not qualified or qualifiable, and very costly to an employer, considering time involved in interviewing and screening."

State of California

Memorandum

Health and Welfare Agency

F-0505

To : Joseph Sarzoza #55

Date : March 28, 1975

File No.: 57:19:bc

From : Department of Human Resources Development
Acting Chief, Employment Data and Research Division

Subject: EMPLOYMENT SERVICES BOARD SURVEY

Attached is our analysis of the Employment Services Board survey of employer attitudes regarding the Employment Development Department. You will be pleased to know that almost half of the employers responded to the questionnaire and many of these took the time to elaborate their views in the comments section. We have analyzed both the responses to the individual questions and the write-in comments. You will find that the survey has obtained a good picture of EDD's image in the employer community.

The success of the ESB survey has depended on a great number of people in the Employment Services Board, in the Employment Development Department, and in the employer community. To single out any one of them for thanks would be an injustice to the many others without whose cooperation this project would not have been possible.

We are confident that the results of this survey will be of value in improving the department's services and effectiveness. We appreciate the opportunity to have participated in this very interesting project and hope to be of service to your future efforts.

Charles Orloff
CHARLES ORLOFF

Attach

cc J. Wyhlidko #89

I. EXECUTIVE SUMMARY

The purpose of the survey was to determine the attitudes of employers about the employment services of the Employment Development Department. Questionnaires were mailed to 21,000 employers randomly selected from Unemployment Insurance tax records. The response rate was close to 50 percent. The questionnaire was designed by the Employment Services Board and pretested on 150 employers.

The responses to the survey indicate that the Employment Development Department (EDD) does not have a favorable image with the employer community.

For many employers, EDD has an image that is dominated by negative feelings toward the Unemployment Insurance program, toward the quality of EDD applicants, and toward the burdens of government bureaucracy in general. These negative feelings are more intense with the small employers who often feel that they are paying for a service which they do not need or cannot use. The large employers responded more favorable, but even the favorable comments were often qualified. Among the employers who do use EDD services, the major concerns seem to be the quality of applicants and the adequacy of screening. EDD seems to have an image that its applicants are less qualified and less motivated to work than applicants from other sources.

The remainder of this report is divided into two sections and an Appendix. Section II is the Analysis of Questions; it summarizes and highlights the quantitative analysis of the fourteen multiple choice questions in the ESB survey. The complete quantitative information is presented in a series of tables in the Appendix. Section III is the Preliminary Analysis of Employer Comments; it presents a qualitative analysis of the comments section of the ESB questionnaire.

II. ANALYSIS OF QUESTIONS

This section highlights the significant quantitative results from the ESB questions. The responses from employers were key punched and tables were prepared by the computer. The narrative description corresponds to the tables in the Appendix. The reported numbers do not always add to the totals because some employers gave more than one answer to some questions and no answer to other questions.

Employer Sample

A sample of 21,000 employers was randomly selected from a universe of 347,023 UI covered employer reporting units. Approximately 94% of the employers in the sample had less than 50 employees and 6% had 50 or more employees. The large employers, although they only represent 6% of the survey, represent over 60% of the employment. The sample was selected not to represent employment or employment potential, but rather to represent individual employers. Therefore, the large firm with many thousands of employees and hundreds of hiring authorities was given the same weight as the small "Mom and Pop" establishment that does very little hiring. This sampling method provided the best cross-section of all employers in California obtainable through EDD records.

Employer Responses by Industry and by SMSA

An analysis of the employers who responded to the survey questionnaire shows that the majority were in service industries or wholesale and retail trade. There are wide variations among the Standard Metropolitan Statistical Areas. The largest SMSA is Los Angeles County. Second in size is the San Francisco-Oakland area. The employment composition of these areas is primarily industrial, with the principal industry being manufacturing. Yet these were not the employers who responded to the survey questionnaire. In Los Angeles, for example, the majority of employers who responded were in service industries with those in trade a fairly close second; only 75 of those engaged in manufacturing answered the questionnaire.

Representative of the middle size SMSAs in the state are San Bernardino-Riverside-Ontario, Oxnard-Simi Valley-Ventura, San Diego, and San Jose. The major industries in these areas are concentrated in aerospace with government, trade, and service employment playing a major role. It is interesting to note, however, that the employers who responded to the questionnaire were engaged primarily in trade and in service industries.

The remainder of the SMSAs combine industries which are akin to agriculture such as in Stockton, Modesto, Salinas, Santa Barbara, Santa Rosa, and Fresno with the more usual components of an industrial area. In Sacramento the most important industry is government. Yet as in other SMSAs, the majority of employers who responded to the questionnaire were engaged in service industries and in trade.

Community Advisory Committees

In the responses concerned with employer knowledge of their local Community Advisory Committees, 8,414 employers answered the question. Of those answering, 5,400 had no knowledge of the committee; 1,542 had heard of it but were ignorant of its activities; and 1,472 knew of its activities. The largest number of those who were aware of the Community Advisory

Committee's activities occurred in the Los Angeles-Long Beach, the San Francisco-Oakland, the Stockton, and the San Diego areas. Among those who had no knowledge of the Community Advisory Committees, the greatest number were in the Oxnard-Simi Valley-Ventura area followed by the San Francisco-Oakland, Sacramento, and San Jose areas. There was little correlation between the size of the area and employer knowledge of the activities of Community Advisory Committees.

Contacts by the Department's Field Offices

The majority of employers who responded to the questionnaire were never contacted by an EDD field office either by mail, telephone, or personal visit. If they were contacted by a field office, telephone and mail were the most frequent ways. The areas in which occasional contact was noted were primarily Santa Barbara, Stockton, San Diego, Modesto, Santa Rosa, and San Jose. The highest number of frequent contacts was in Santa Barbara with Modesto and the San Francisco-Oakland area not far behind.

Purpose of Contacts

The purposes of the field office contacts with employers were interesting. Statewide, 1,285 contacts were to solicit job openings and 1,210 contacts were to provide information concerning the UI or DI programs. Forty percent (40%) of the employers reported no contacts with any EDD field office in the last 12 months; an additional 27% did not answer the question. The greatest number of those contacted to solicit job openings occurred in the Los Angeles-Long Beach area and in Modesto. The largest number of those having no contact with EDD staff occurred in the Sacramento, San Francisco-Oakland, Oxnard-Simi Valley-Ventura, and Los Angeles-Long Beach areas.

Results of Contacts

Most employers felt that the results of field office contacts with them were positive. On a statewide basis, 766 of the employers felt the contact promoted understanding, 710 placed a job order, and 843 felt that the services of the Department were of no value to their firms. Santa Barbara ranked the highest in acquiring job orders followed by Modesto and San Jose. The employers who felt that the services offered by the Department were of no value to their firms were heaviest in the Los Angeles-Long Beach area followed by the Vallejo-Fairfield-Napa, Modesto, Fresno, and San Francisco-Oakland areas.

Reasons for Increasing or Decreasing Use of EDD

Tables VI and VII in the Appendix compare the reasons for increasing the use of EDD services with the reasons for stopping the use of EDD services. Of the employers who responded, 1,458 had recently increased their use of EDD services. Eighty-five percent (85%) of the employers did not answer this question. Of those who did, 218 attributed the increase to visits by EDD employer representatives; 165 to receiving brochures; 91 to promotional telephone calls; and 92 to recommendations by business associates.

A large number (2,030) of employers had stopped using the services of the Department. By far the most prevalent reason was the poor quality of referred applicants (793). Other reasons were that the Department did not fill orders (260) or that the service was very slow (115). Eighty percent (80%) of employers did not respond to this question.

Services Used in Last Twelve Months

More than 5,500 employers used none of our services in the last 12 months. Approximately 1,200 employers used the placement services of the Department; 655 received assistance on UI or DI claims; and 260 received labor market information.

Categories of Job Openings

The largest number of employers in the survey who listed any job openings with EDD listed openings for office and clerical staff (578). Job openings for those in service occupations (412) and for production workers (348) were the second and third most frequent categories listed with EDD. Fewer openings in sales work or in professional, technical, and managerial occupations were listed with EDD. Only 16% of the employers listed any job openings at all with EDD in the last 12 months. Responses concerning the percent of job openings listed with EDD appeared to be unreliable, therefore they were not tabulated.

Quality of Applicants

An important question in the survey concerns employer reaction to the quality of applicants referred by the field offices during the last 12 months. About 1,300 of the employers had applicants referred. Of those only 88 employers felt that the quality of the applicants was excellent, with the largest number of those in Santa Barbara and Modesto. A total of 736 employers felt the applicants were satisfactory. The employers responding in this fashion were pretty evenly scattered throughout the metropolitan areas of the state, except for Bakersfield where only five employers checked the applicants as satisfactory. A large number of employers (487) felt that the quality of the applicants was unacceptable.

Hiring Sources

According to the responses, only 4,496 of the employers (50%) indicated that they hired employees during the last twelve months. Of those who did hire, 1,503 used the news media as a source; 960 used the services of private employment agencies, and 847 used EDD field offices. An estimated 1,469 checked "other" as a source of hires during the year. The "others" were usually friends or relatives of those already working for the employer or walk-in applicants.

Rating of EDD's Effectiveness

Only forty percent (40%) of the responding employers rated EDD's effectiveness in aiding their recruiting efforts. The largest number of employers rated EDD effectiveness as of no value to them (1,385). More than three times the number of employers rated EDD effectiveness as good or satisfactory (1,110) as did those who rated EDD effectiveness as unsatisfactory (327).

III. PRELIMINARY ANALYSIS OF EMPLOYER COMMENTS

Approximately one fifth of the employers who responded to the Employment Services Board questionnaire made comments. These comments proved to be an important part of the information contained in the responses, therefore a special analysis of the comments was undertaken. This section describes and analyzes the comments from 1252 employers. Approximately 75 of the comments are directly quoted in order to provide a representative picture of the responses. Experience indicates that it is usually those employers who have stronger than average feelings who go to the trouble to write in their comments.

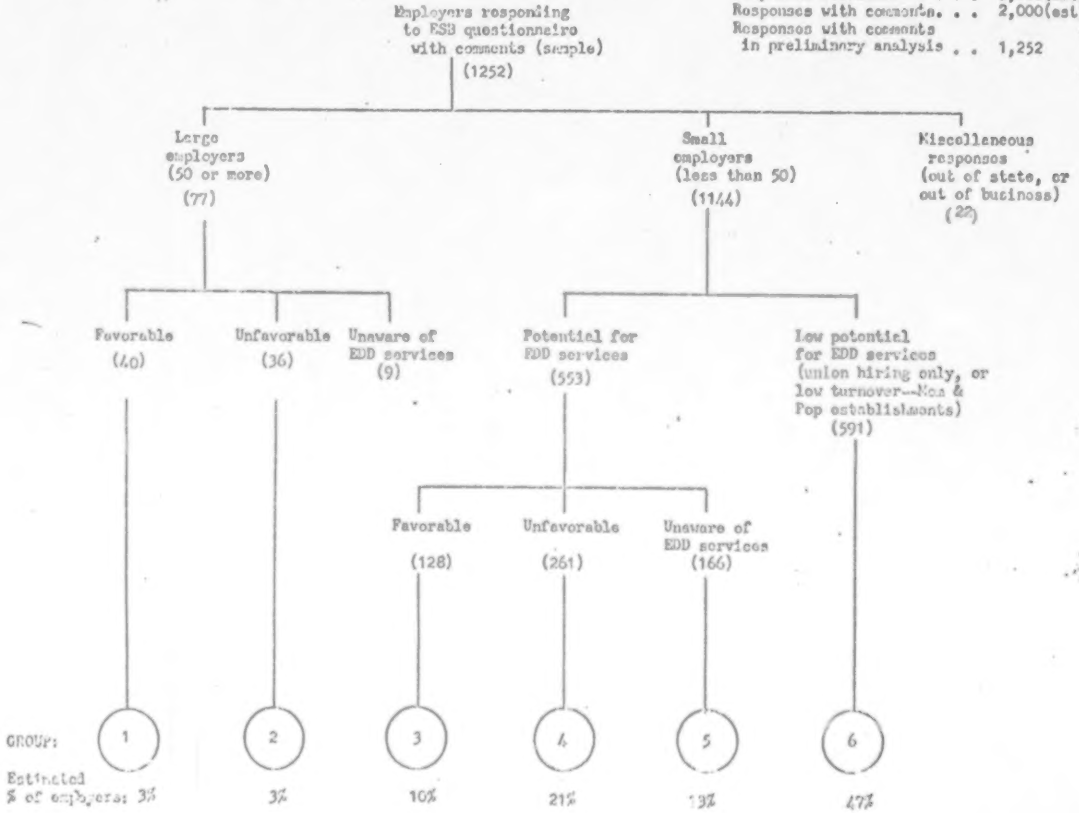
The sample of employers who wrote comments in reply to the ESB survey were divided into the following six (6) categories (see Chart A):

1. Major market employers (more than 50 employees) who evidenced a favorable image of EDD placement services. (3%)
2. Major market employers who evidenced an unfavorable image of EDD placement services. (3%)
3. Minor market employers (50 or less employees) who evidenced a favorable image of EDD placement services. (10%)
4. Minor market employers who evidenced an unfavorable image of EDD placement services. (21%)
5. Minor market employers who were unaware of, or did not feel they could rate EDD placement services. (13%)
6. Minor market employers who had low potential for utilizing EDD services. (47%)

Chart A

PRELIMINARY ANALYSIS OF ESB QUESTIONNAIRE COMMENTS

Questionnaires mailed. . . . 21,000
Responses received. . . . . 9,000(est)
Responses with comments. . . 2,000(est)
Responses with comments
in preliminary analysis . . 1,252


Employers responding to ESB questionnaire with comments (sample) (1252)
Large employers (50 or more) (77)
Small employers (less than 50) (1144)
Miscellaneous responses (out of state, or out of business) (22)
Favorable (40)
Unfavorable (36)
Unaware of EDD services (9)
Potential for EDD services (553)
Low potential for EDD services (union hiring only, or low turnover--Mom & Pop establishments) (591)
Favorable (128)
Unfavorable (261)
Unaware of EDD services (166)
GROUP:
1
2
3
4
5
6
Estimated % of employers: 3%
3%
10%
21%
13%
47%

Favorable Major Market Employers (N=)

Approximately one half (17) of the large employers evidenced an unqualified favorable stance toward EDD placement services. They indicated that the service was good because it had improved over the past few years or because there were particularly pleased with their relationships with ESR's and field office staff.

However, the remaining half of the major market employers suggested that they had a basically favorable image of EDD's placement service, but qualified their stance. They suggested a sense of understanding or sympathy with EDD's circumstances and that the effectiveness of the service varied depending upon the interviewer, the office, and the level of applicant skills requested. Other employers indicated that EDD was effective in responding quickly but that the employer could get better applicants (more motivated and less critical of salaries offered) through newspapers and other resources. It should also be noted that a few favorable employers expressed a positive image of EDD, but preferred to maintain their independence and self-reliance in recruiting personnel.

Some comments from major market employers who rated the Department's effectiveness as good or satisfactory were as follows:

> I would like to comment on extremely cooperative attitude of all department personnel with whom I've been in contact. In many phone conversations over the past nine months, not once have I encountered rudeness or lack of response. In these times of high unemployment, that is particularly laudable, and I compliment all of you!
>
> In relation to questions 12 and 14, service was very satisfactory for general labor positions. However, for clerical, skilled labor, professional, and managerial positions the service was poor. Screening was haphazard

at best, referrals were few for mo positions, and, despite specific requests to the contrary, applicants were often referred without an appointment.

Prior to 1974 applicants referred did not meet requirements of job order. Situation improved since.

On Question #12, answer would depend on EDD interviewer--some are less skilled than others in referring good candidates. General quality would be somewhat less than satisfactory.

I have been in contact with State employment services across the United States with little or no respect for them. Upon being transferred to Gilroy, I was hesitant to use the local office. However, I was amazed at the efficiency, high quality of applicants in relationship to the job at hand, the thorough amount of training that the office administered in some cases--etc. I was totally pleased with the local office and I will continue to utilize their services.

I realize that staffing is a problem but many times the referrals do not meet our appearance standards/or have a poor work history or attitude problem--it appears that the applicant is only "looking" to maintain his UI eligibility. Overall the referrals are satisfactory with regard to qualifications.

The department is becoming more courteous. The applicants are getting better. There appears to be little in the way of professional and technically trained applicants. I have had no contact about OJT training from EDD. Vocational Rehabilitation has made many contacts. Service has generally improved during the last five years.

Unfavorable Major Market Employers (N=37)

Large employers who evidenced an unfavorable stand toward EDD placement services tended to divide their basis of criticism between the screening skills of EDD staff, and the characteristics of the applicants who report to them. Employers who were critical of screening skills recommended that interviewers consider more than applicant skills in their selection. They suggest that personal characteristics be taken into account. They sometimes attributed their lack of screening to a goal of moving people off Unemployment Insurance or Welfare Benefit rolls. The most typical response (64% of the unfavorable employers who wrote comments) stated, in effect, that the service itself was somewhat satisfactory, but limitod in its effectiveness to provide qualified and motivated applicants who were willing or able to comply with employers expectations.

Some employers criticized the EDD placement system as a factor which hindered its effectiveness.

Some of the comments of major market employers who rated EDD's effectiveness as unsatisfactory were as follows:

> It seems to be a people mill, with little or no counseling on the Department's part so that applicants end up just looking for a job, not a position or career. Companies really don't want to merely fill a vacancy, but want real long term contributors. More appreciation for the employers needs rather than the Department's needs to move people out of unemployment lines is needed.
>
> I do not wish to sound as though I am making a blanket condemnation of the Department's services. There have been isolated individuals who have been helpful and appeared to be seriously interested in being of assistance. The majority appear to be normal Civil Servants who are putting in their time on the Roman Dole and prefer not to be bothered. Therefore the majority of my recruiting of personnel has to be newspaper ads, private agencies and other media.
>
> If the Department was more effective we could eliminate agencies. Somehow the Department has to reach prospective applicants and take advantage of the fact that they have the same opportunity to place an individual as an agency but yet the Department can not fulfill our requirements as the agencies can.
>
> EDD is concerned with "processing" applicants and not in filling job orders. The size of the local office has increased to the point where bureaucratic confusion renders them ineffective. It's too bad because they could and should be a primary source of referrals.
>
> The present system eliminates the personal contract we once enjoyed when placement personnel had a good understanding of the job requirements and the qualifications we required of an applicant. The new systems provides us with lots of

> people to talk to but who become disappointed or discouraged because they are not qualified or qualifiable and very costly to employer considering time involved in interviewing and screening.
>
> Apparently the department does not get a large supply of qualified applicants who are really seriously interested in a commitment to full employment with all of the burdens and responsibilities that this implies.
>
> The employees of the Employment Development Department were courteous and concerned. The fact that the applicants sent were unacceptable was a situation beyond their control.
>
> (1) Referral service for permanent openings is slow.
> Referral service for temporary labor is excellent.
> (2) It is somewhat frustrating to list openings with "Job Bank". I prefer the former procedure, listing with the referrer.
> (3) In listing "statewide", I found I was still being sent resumes for two months after I closed the order.

Favorable Minor Market Employers (N=128)

Small employers who expressed a favorable stance toward EDD placement services fell into three groups.

The first group (comprising 37% of the small favorable employers) made unqualified favorable comments. They indicated that they had tried EDD and were pleased with the service and the results.

The second group (30% of the favorable small employers), made positive statements about EDD, but had not used the placement service. They were pleased with information received or with the way UI and SDI claims were dealt with. They typically made references to the cooperativeness of the staff.

The third group (33% of the small employers who rated EDD's effectiveness in meeting their recruitment needs) qualified their satisfaction. These employers stated, in effect, that the service was good, but the applicants either didn't stay on the job, were unmotivated or unqualified. These employers seemed sympathic to EDD and satisfied with its effort to cooperate, but were not totally satisfied with its results.

Some of the comments from small employers who were basically favorable toward EDD were as follows:

> When we did have a need to call we received very good response.
>
> In past years we tried several times but the applicants were not qualified for our type of work. The Department's efforts were good.
>
> The response of the service is very good, in our particular case our business is pretty well established and therefore our employment is also stabilized, so therefore we didn't have to make any contacts with the service for hiring more employees.
>
> Poor calibre of applicants referred by the California Employment Service. Through the Department. I received courteous attention but the people sent to me would not work. They had rather draw unemployment.
>
> Department representatives have made a sincere effort to obtain qualified people for the job.
>
> Have always used California street office when we have had openings. Service has been good. Department does better job of screening applicants than private agencies.
>
> Your personnel show much more professionalism than when I tried to use your Department 3 to 5 years ago - We interviewed some well qualified people referred by you on the opening placed with your department, this year.
>
> Very good.
>
> We have called local field office at various times for varied questions and have found them to be most cooperative.
>
> Prior to the past three months potential employees have generally been unsatisfactory in appearance, work habits, etc. Since being contacted by...of the Oxnard Office, Job Training Department, the quality of applicants has improved immensely. This is probably due to the time...took thru

> an extensive interview to discover our needs. This was never suggested or done in the past.
>
> Keep up the good work and cut down on our unemployment.
>
> Have used services of employment office in past year and service was good. During this year we only needed one girl and tried private agency.
>
> The department is helpful and efficient--it is the caliber of applicants that is the problem and this is not the fault of the department--they send out what they have registered. Hope this helps--this questionnaire is very good.

Unfavorable Minor Market Employers (N=261)

The number of small employers who expressed dissatisfaction with EDD placement services outnumbered those who favored EDD services two to one (compared to a one to one ratio among large employers). This might be an expression of frustration by employers who have a more difficult time recruiting applicants because they are less known, offer less benefits, offer less desirable duties and/or offer less identity status in the community.

The majority of employers in this category (43%) tended to be critical of the quality of applicants who were sent out to them. They too described the applicants as lazy or unmotivated, unqualified, or inappropriate in terms of dress and general demeanor.

Some employers (30%) who expressed dissatisfaction stressed the idea that the system (either the legal-social system or the EDD system) was responsible.

They were critical of the availability of UI and welfare benefits; government and it's bureaucracies; of the perceived focus on minorities rather than qualifications; of antidiscrimination laws which prevent them from hiring who they want to, and of insufficient services (typing tests, etc.).

Other employers (14% of this group) were more critical of EDD's selection skills than they were of the applicants themselves. Their comments reflected an image of carelessness and apathy on the part of EDD staff in referring applicants to them. Others just complained that they received little or no response to their job listings.

Finally, some employers (13%) expressed dissatisfaction with EDD, but were vague in describing the factors which fostered it. Some made references to UI separation issues, some referred to the cost of the service (including this study), and some merely stated that they preferred to do their own recruitment.

Some of the comments made by employers in this category include the following:

> I think UI is paid too often to people who really don't want to work more than a minimum per year to keep on the "Vacation Gravy Train" of unemployment paid by their employers. The statement too often is heard "Go on the rocking chair money--I've got it coming". The program is totally abused with the employer footing the full bill including the costs of this questionnaire.

> Man should have an incentive to work. The high unemployment benefits take this away from the unskilled and untrained. As far as unemployment and welfare for the able bodied we should start a movement toward you no work--you no eat!

> You want the truth. I am sorry to tell you--people coming direct from any government agency--have never worked out. Only use--my various farming partners--come one or two days then rush back to file Welfare Claims. When we hustle our own employees and do our own talking--it works much better.

> The type of help we need (journeyman machinist) just is not available through EDD.

> We are a small hotel requiring only one maid. We have used your office over the years and the quality of help referred was extremely poor. The blame does not belong to your office

and employees. Every one of the ladies referred said they were the greatest maid in town. All we can do is try them and analyze which your office cannot.

Our preference is to seek and hire our own people from the immediate locality. We try to enlist persons we know personally to assure quality.

We find that if a person is now on unemployment checks or welfare--they do not truly try to be hired. They want all aid to expire before they seek work. We do not hire over ten people and some jobs are minimum pay--they will not hire in for this even though we give hospitalization--work daylight hours only and are open only five days weekly. We try to keep our employees happy because new help is extremely difficult to find.

Previous experience with departmental placement was a disaster. Attempts to shove an unqualified, untested, unsuitable person down our throats, have resulted in a permanent antipathy toward the department. Posting of a technical position two years ago which ran for a full year proved fruitless. It turned out that since our particular requirement was a new category that did not have a separate listing, it was included in a wrong category. Some service! Inflexibility of the system makes it unworkable for us. Such bureaucracy we don't intend to work with.

Have not contacted in recent years because prior experience showed applicants were not screened and had to weed out people who did not want to work, that came out on interview only to keep eligible for unemployment. A simple ad in paper brings only peope who want to work.

We get the impression that the bulk of the department staff (in local office) is primarily concerned with processing benefits for the unemployed and considerably less interested (and/or capable) in placing people in jobs. We fail to note that even the most rudimentary interviewing has been accomplished before an applicant is sent to us.

In the past 15 years I may have called for your help four to eight times? I have only hired one man through your department. As I recall the people were somewhat indifferent to my requirements. I guess that may be why I don't ever call your department. I found the best way to hire capable enthusiastic and loyal personnel is through our suppliers, their salespeople and word of mouth. Hope this is of help to you.

In the past whenever I enlisted the help of placement service, either no applicants ever showed up or the quality of applicant was so poor it turned out to be a waste of everyones time. I think this service could be of great value to employers and potential employees, but when I hire I remember my past experience and decide not even to bother looking for employees at the placement service. Hope something is done to improve matters.

The impression I receive from your staff is that they do not care! This means they don't care about employers or employees to be.

Question #8 I have found private agencies worked at getting me together with the right person--whereas the department seemed to send over anyone with the basic skills without a look into aptitude or other qualities I am looking for--is it discriminating to want certain types?

On company personnel, I have never had a good applicant from your department. The applicant is not screened and I've been sent bookkeepers when I've asked for general office, for filing, extension work, etc. My experience in the past has been, if you need someone qualified for a certain position, don't call the department. So I've gotten in the habit of not calling the department.

We have tried on several occasions to get employees through you but to no avail. I can only pay the minimum wage so most welfare people are not interested not that I blame them. With wages, taxes, insurances, goods and rent on the increase I can see no change for the better in 1975.

When contacted the applicants sent for interview is recruited from the person sitting with them at the time--not from file of qualified personnel seeking employment. Seems to be some personal feelings involved too. No sharp people were sent to us. Only unqualified ignorant and their excuse was these are all that are available. Independent employment offices sent people but they usually become disillusioned by the high cost of getting the job and quit after they realized how much they were paying for the privilege of working.

Minor Market Employers Who Were Unaware of EDD Services (N=166)

This category of employers (13% of the sample) included those who indicated that they were not familiar with the ESB; not familiar with EDD but who wanted more information; or employers who felt they could not rate us because they did not see any way we could be of value to them.

Comments from some of these employers were as follows:

I would like to know more about your services.

We would like to know more about the services offered by your offices, including the Community Advisory Committee.

I am not very familiar with the departments services, but, would be interested in learning about them.

We would like to use this service but, as an employer I don't like to get countless referrals for a small opening therefore, I do not know if I am of service to them.

Have no employee problems.

I had only one job opening. I preferred news media, to be able to eliminate and narrow down choice of applicants at first telephone interview. I'm going to try the Employment Development Department next time.

1. I'm prejudiced against workers who are not willing to actively look for their own job.
2. I believe all looking for work should also register with your department.
3. I dislike the over aggressive (at times) way private agencies solicit openings but think your department would improve if they spent some time this way.
4. In five years I have had only one person inquire (personally) for a job.
5. I have openings but no time to train candidates.
6. OJT has great potential--if tied to manufacturing training program and not to outdated equipment (like trade schools have).

We are a very small business. Our hiring usually would be limited to fully experienced personnel. Experienced people looking for jobs usually circulate the agencies themselves either directly or through one of the airline sales representatives.

I own a small beauty salon--have only two employees. One full time - one part time.

We were never contacted.

We are a Service Club and utilize food service people working for local school district when needed.

I will try to use your department now, for I have a new opening.

> Our firm will utilize services of your department, but we would like to meet with a representative. If your department has to do with WIN-OJT then most of my answers should have been in the affirmative.
>
> We would not be interested in using this service.
>
> Have no need of help in securing employees.
>
> As a very small architectural office there has been little or no need for such a service as your board offers. At sometime in the future, when the general economy improves and construction money is again available at a reasonable interest rate, it is possible your services could be of benefit to me. With this in mind, it would be nice if your field representative would contact me and advise me on your available services. Thank you for your efforts to improve the State's image. It would also help if the employer tax contribution rate was eliminated, or at least reduced substantially.

Minor Market Employers With Low Potential For Utilization Of EDD Services

(N=591)

This category of employers is comprised of very small businesses which hire one or less full-time employee. which engage in union hiring only, and/or which have virtually no turnover.

Some comments from employers in this category were as follows:

> We are a family operation with most of our employees being family members. We have very little employee turnover.
>
> Only have two employees, one a son and the other a son-in-law, which seems to work out the best for this very small business.
>
> As manager, I have been with the credit union since organization. The second employee was referred by a mutual friend--has been in the position for two years. No replacement or additions are contemplated.
>
> We hire part-time people and they are all attending school.
>
> Small musical group. Must hire through union.

Aero TV is a one man store.

I have one employee. He is a professional photographer and a good friend. We have a two man operation. He has been with me for several years. At this time there is no place for other employees in my small business.

I have had no employees in last 2 1/2 years.

We are so little that our hiring is done chiefly through union.

Mobile home park managers and assistant managers have to be owners and dwell in park, etc., so do not believe the older retired couples could be recruited other than through mobile papers.

The amount of paperwork for one part-time employee (an apartment manager) is ridiculous.

Money is being wasted. Must hire through union.

I am a small business and do not net a large profit to hire steady. The job requires a special type person to sell used merchandise. So I do my own scouting for a worker. It's a business where you do good one day and nothing the next. As of now I am working it alone as I cannot afford an employee. I do not wish your service for any employee. So do not refer any to me! As they will not be hired.

Just hired one part-time employee.

Have only one employee and probably don't need help.

APPENDIX

Table	Title
I.	Responses by Industry and Size of Firm
II.	Relationship With Community Advisory Committee
III.	Contacts Made With EDD Office During Last 12 Months
IV.	Purpose of Contacts Made by EDD Office
V.	Results of Contacts With Local Office Staff
VI.	Reasons for Increasing Use of EDD Services
VII.	Reasons for Stopping Use of EDD Services
VIII.	Types of Local Office Services Used by Employers
IX.	Type of Job Openings Listed With EDD Office
X.	Quality of Applicants Referred by EDD During Last 12 Months
XI.	Source of Hires Made During Last 12 Months
XII.	Employer's Rating of EDD Effectiveness
Exhibit	Employment Services Board Questionnaire

State of California
Employment Development Department

Employment Data and Research

EMPLOYMENT SERVICES BOARD EMPLOYER SURVEY

Table I

Responses by Industry and Size of Firm

Industry	Total	Under 50 EES	Over 50 EES	No Response
State Totals	8,938	7,793	563	582
Agriculture, Forestry, & Fisheries	230	195	11	24
Mineral Extraction	27	21	5	1
Contract Construction	849	736	25	88
Manufacturing	642	495	115	32
Transportation, Communication, Electric, Gas, & Sanitary Services	345	294	19	32
Wholesale & Retail Trade	2,861	2,536	154	171
Finance, Insurance, & Real Estate	777	650	54	73
Services	3,077	2,789	142	146
State & Local Govt	58	22	35	1
Nonclassifiable	72	55	3	14

State of California
Employment Development Department

Employment Data and Research

Table II

Relationship With Community Advisory Committee

Area	Know of Activities	Heard of it But Ignorant of Activities	No Knowledge	No Response	Total
Anaheim-Santa Ana-Garden Grove	77	89	353	40	559
Bakersfield	13	13	30	5	61
Fresno	68	102	362	37	569
Los Angeles-Long Beach	139	84	290	36	549
Oxnard-Simi Valley-Ventura	65	94	369	41	569
Sacramento	80	94	355	33	562
Salinas-Seaside-Monterey	100	110	293	18	521
San Bernardino-Riverside Ontario	92	91	337	38	558
San Diego	102	94	331	34	561
San Francisco-Oakland	104	100	366	34	604
San Jose	71	101	354	34	560
Santa Barbara	91	111	336	29	567
Stockton	105	89	301	36	531
Vallejo-Fairfield-Napa	80	86	351	27	544
Modesto	98	113	345	34	590
Santa Rosa	98	76	353	28	555
Santa Cruz	89	95	274	23	481
State Totals	1472	1542	5400	527	8941

Employment Development Department

Table II

Contacts Made With EDD Office During Last 12 Months

Area	Frequently	Occasionally	Seldom	Never	No Response	Total
Anaheim-Santa Ana-Garden Grove						
Personal	1	15	22	391	130	559
Mail	9	55	58	263	175	560
Telephone	7	32	38	305	178	560
Bakersfield						
Personal	0	3	0	45	13	61
Mail	2	9	5	24	21	61
Telephone	1	3	3	30	24	61
Fresno						
Personal	3	26	37	370	131	567
Mail	4	46	42	275	201	568
Telephone	2	40	38	305	184	569
Los Angeles-Long Beach						
Personal	5	34	30	339	141	549
Mail	13	77	48	232	179	549
Telephone	6	49	32	278	184	549
Oxnard-Simi Valley-Ventura						
Personal	2	20	20	399	128	569
Mail	3	45	60	283	174	570
Telephone	8	38	40	317	165	568
Sacramento						
Personal	2	24	27	388	122	563
Mail	10	46	65	270	171	562
Telephone	5	25	42	320	169	561
Salinas-Seaside-Monterey						
Personal	2	38	42	345	94	521
Mail	7	52	39	259	164	521
Telephone	9	43	39	279	151	521
San Bernardino-Riverside						
Personal	4	30	33	368	124	559
Mail	6	52	49	248	204	559
Telephone	5	39	44	274	194	556

[illegible]

Area	Frequently	Occasionally	Seldom	Never	No Response	Total
San Diego						
Personal	4	15	37	377	127	560
Mail	9	61	71	244	176	561
Telephone	7	36	54	300	162	559
San Francisco-Oakland						
Personal	2	24	35	414	129	604
Mail	14	65	53	273	192	603
Telephone	14	49	39	331	170	603
San Jose						
Personal	1	13	13	430	103	560
Mail	9	61	70	281	139	560
Telephone	5	36	44	340	135	560
Santa Barbara						
Personal	3	47	39	366	113	568
Mail	8	74	53	257	174	566
Telephone	19	51	51	288	158	567
Stockton						
Personal	7	31	41	347	106	532
Mail	9	61	42	243	176	531
Telephone	6	45	40	273	166	530
Vallejo-Fairfield-Napa						
Personal	10	32	36	365	101	544
Mail	6	54	51	257	176	544
Telephone	16	39	32	290	167	544
Modesto						
Personal	9	44	42	360	134	589
Mail	16	81	62	239	191	589
Telephone	12	63	56	286	173	590
Santa Rosa						
Personal	5	25	27	366	132	555
Mail	8	46	47	279	175	555
Telephone	13	42	34	305	161	555
Santa Cruz						
Personal	4	25	28	314	109	480
Mail	7	43	57	207	166	480
Telephone	5	53	51	242	130	481
State Totals						
Personal	64	5934	509	446	1937	5947
Mail	140	4144	872	929	2354	5947
Telephone	140	4763	677	683	2671	5947

Table [illegible]V

Purpose of Contacts Made by EDD Office

Area	Explain Services	Solicit Job Openings	Solicit Participation in Job Training	Gather Labor Market Information	Information on UI or DI Program	Other	No Contacts	No Response	Tot
Anaheim-Santa Ana-Garden Grove	41	64	25	17	80	8	232	165	632
Bakersfield	5	6	2	4	10	0	27	16	70
Fresno	37	67	36	16	65	8	234	171	634
Los Angeles-Long Beach	69	114	41	29	64	9	175	165	666
Oxnard-Simi Valley-Ventura	21	56	35	11	72	11	267	155	629
Sacramento	47	71	39	12	78	11	238	154	650
Salinas-Seaside-Monterey	50	77	34	23	70	17	205	141	617
San Bernardino-Riverside-Ontario	46	77	25	17	63	7	235	[illegible]	
San Diego	58	90	51	13	81	9	223	140	665
San Francisco-Oakland	49	95	27	16	80	16	238	179	700
San Jose	49	80	31	16	72	10	223	157	638
Santa Barbara	55	81	50	19	91	20	216	144	676
Stockton	60	83	40	18	71	8	203	142	630
Vallejo-Fairfield-Napa	53	67	36	18	83	12	221	147	637
Modesto	45	114	75	22	89	18	224	132	719
Santa Rosa	41	66	32	12	78	14	225	155	[illegible]
Santa Cruz	39	77	22	27	63	17	188	118	[illegible]
State Totals	765	1285	601	290	1210	195	3979	2436	[illegible]

Table V

Results of Contacts Made With Local Office Staff

Area	Strengthened Relations	Promoted Under-Standing	Agreed to Participate in a Training Program	Placed a Job Order	Of No Value To My Firm	Other	No Contact Made	No Response	Total
Anaheim-Santa Ana-Garden Grove	20	30	6	36	58	18	242	179	589
Bakersfield	1	6	0	5	3	1	29	21	66
Fresno	16	41	10	27	60	13	239	190	596
Los Angeles-Long Beach	19	50	6	47	64	23	188	182	579
Oxnard-Simi Valley-Ventura	18	36	15	41	37	15	274	171	607
Sacramento	17	46	9	43	58	20	246	174	613
Salinas-Seaside-Monterey	32	44	10	49	44	18	219	149	565
San Bernardino-Riverside-Ontario	16	41	2	43	43	14	252	165	576
San Diego	22	46	12	38	70	21	231	159	599
San Francisco-Oakland	26	54	11	37	59	14	239	200	640
San Jose	13	44	10	56	46	17	234	174	594
Santa Barbara	33	68	18	60	47	25	223	154	628
Stockton	27	58	6	48	57	17	203	167	583
Vallejo-Fairfield-Napa	32	46	11	42	39	20	224	177	591
Modesto	24	68	30	57	61	30	229	150	649
Santa Rosa	22	47	13	40	53	14	233	171	593
Santa Cruz	28	41	4	41	44	20	197	133	[illegible]
State Totals	366	765	173	710	843	300	3702	2716	6947

Table VI

Reasons for Increasing Use of FDD Services

Area	Visit by FDD Staff	Telephone Call	Radio or TV	Brochure	Newspaper	Govt. Contract	Recommended by Associate	Other	No Response	Total
Anaheim-Santa Ana-Garden Grove	9	2	0	16	0	10	4	50	479	570
Bakersfield	1	1	1	2	1	1	0	5	50	62
Fresno	17	4	1	12	5	2	6	42	489	578
Los Angeles-Long Beach	11	4	0	11	0	4	3	40	479	552
Oxnard-Simi Valley-Ventura	12	3	0	7	6	2	10	45	490	575
Sacramento	12	5	2	13	3	4	5	47	485	576
Salinas-Seaside-Monterey	22	2	3	7	7	2	10	39	439	531
San Bernardino-Riverside-Ontario	14	6	1	11	6	6	2	46	471	563
San Diego	10	5	3	15	3	7	3	33	489	568
San Francisco-Oakland	5	4	0	8	9	8	3	41	530	608
San Jose	6	8	2	12	5	2	7	54	470	566
Santa Barbara	24	9	5	9	7	6	7	44	471	582
Stockton	16	7	0	11	4	5	8	30	456	537
Vallejo-Fairfield-Napa	19	10	4	9	6	5	3	50	449	555
Modesto	18	8	1	11	5	4	10	49	495	601
Santa Rosa	9	7	5	7	7	5	5	44	472	561
Santa Cruz	13	6	6	4	7	7	6	38	397	484
State Totals	218	91	34	165	81	80	92	697	7511	8947

Table [illegible]I

Reasons For Stopping Use of EDD Services

Area	Poor Quality of Referred Applicants	Slow Service	Excessive Calls	Did Not Fill Orders	Lost Personal Contact	Other	No Response	Total
Anaheim-Santa Ana-Garden Grove	39	3	5	19	3	45	462	576
Bakersfield	6	1	1	2	0	7	48	
Fresno	47	5	2	20	2	52	449	577
Los Angeles-Long Beach	54	5	5	30	3	40	434	571
Oxnard-Simi Valley-Ventura	44	11	1	12	4	58	453	583
Sacramento	40	5	3	15	2	48	463	576
Salinas-Seaside-Monterey	62	10	3	16	3	35	412	541
San Bernardino-Riverside-Ontario	49	8	2	14	3	55	[illegible]	[illegible]
San Diego	30	3	0	14	5	50	466	[illegible]
San Francisco-Oakland	49	5	5	14	3	38	504	618
San Jose	52	14	2	16	2	51	448	585
Santa Barbara	56	9	2	10	3	37	461	578
Stockton	60	9	3	10	8	31	427	548
Vallejo-Fairfield-Napa	47	10	6	14	5	58	422	562
Modesto	65	9	2	26	7	59	441	609
Santa Rosa	45	6	3	17	3	45	451	570
Santa Cruz	48	2	0	11	3	49	378	491
State Totals	793	115	45	260	59	758	7164	8947

Table VII

Types of Local Office Services Used By Employers

Area	Placement Services	Wage/Labor Market Information	Out Contract Follow-Ups	Assistance On Improving Personnel Policies/ Practices & Others	UI-DI Claims Assistance	None	No Response	Total
Anaheim-Santa Ana Garden Grove	64	14	6	5	36	329	130	584
Bakersfield	11	1	0	1	7	31	13	64
Fresno	57	17	6	2	40	325	143	590
Los Angeles-Long Beach	65	13	3	8	28	317	131	566
Oxnard-Simi Valley-Ventura	65	13	6	6	38	343	125	596
Sacramento	72	13	3	3	24	339	120	597
Salinas-Seaside-Monterey	80	18	8	9	45	295	98	553
San Bernardino-Riverside-Ontario	64	13	2	2	34	331		
San Diego	64	24	6	6	48	326	120	594
San Francisco-Oakland	81	12	6	4	48	354	131	636
San Jose	88	15	3	3	35	327	116	587
Santa Barbara	101	23	14	7	63	293	112	613
Stockton	76	14	5	5	37	308	114	559
Vallejo-Fairfield-Napa	67	13	11	6	52	312	117	[illegible]
Modesto	101	24	16	6	47	337	105	636
Santa Rosa	70	19	4	9	40	312	126	580
Santa Cruz	80	14	4	8	33	275	87	501
State Totals	1207	260	103	90	655	5154	1919	8947

Table IX

Type of Job Openings Listed With EDD Offices

Area	Office and Clerical	Sales	Maintenance	Production	Professional Technical and Managerial	Services	Agriculture	None	Response	Total
Anaheim-Santa Ana-Garden Grove	32	12	15	34	13	19	1	340	135	60
Bakersfield	3	3	7	1	1	7	0	40	8	7
Fresno	33	8	6	11	2	17	6	359	140	5
Los Angeles-Long Beach	30	9	17	35	14	24	0	313	145	5
Oxnard-Simi Valley-Ventura	33	9	19	13	16	24	6	378	112	61
Sacramento	32	10	13	14	16	26	4	372	105	59
Salinas-Seaside-Monterey	40	13	18	15	6	22	12	313	111	55
San Bernardino-Riverside-Ontario	30	10	15	23	9	20	7	337	145	[illegible]
San Diego	34	14	13	23	20	24	2	363	114	607
San Francisco-Oakland	58	13	12	20	12	29	1	360	146	65
San Jose	50	12	23	24	10	30	2	342	114	60
Santa Barbara	47	21	26	29	18	34	4	337	113	6
Stockton	30	6	18	29	13	23	10	321	117	56
Vallejo-Fairfield-Napa	27	7	14	15	17	26	6	360	111	56
Modesto	43	19	34	20	14	41	7	365	100	64
Santa Rosa	29	12	18	20	15	20	3	331	139	587
Santa Cruz	27	24	18	22	9	26	4	289	101	5
State Totals	578	202	286	348	205	412	75	5520	1956	8

Table

Quality of Applicants Referred To You By EDD During Last 12 Months

Area	Excellent	Satisfactory	Unaccept-able	No Applicants Referred	Did Not Request Referrals	No Response	Total
Anaheim-Santa Ana-Garden Grove	5	29	31	88	198	209	560
Bakersfield	2	5	4	8	26	16	61
Fresno	6	25	30	90	213	205	569
Los Angeles-Long Beach	1	38	39	60	215	196	549
Oxnard-Simi Valley-Ventura	4	46	29	96	219	175	569
Sacramento	4	46	19	83	234	176	562
Salinas-Seaside-Monterey	4	55	33	72	195	162	521
San Bernardino-Riverside-Ontario	1	41	29	94	195	198	558
San Diego	6	43	20	83	229	179	560
San Francisco-Oakland	6	44	34	84	227	209	604
San Jose	7	56	32	84	221	159	559
Santa Barbara	10	59	36	77	201	184	567
Stockton	8	49	30	58	223	162	530
Vallejo-Fairfield-Napa	4	43	23	83	215	176	544
Modesto	10	60	44	96	213	167	590
Santa Rosa	6	41	29	82	196	200	554
Santa Cruz	4	56	25	70	182	144	481
State Totals	88	736	487	1308	3402	2917	8947

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Table XI

Source of Hires Made During Last 12 Months

Area	EDD Local Office	Company's Personnel Office	Private Employment Agency	Business and Technical Schools	News Media	Union Halls	Community Agency	Other Sources	No Hires	No Response	Total
Anaheim-Santa-Ana-Garden Grove	40	31	52	28	128	29	14	83	125	147	677
Bakersfield	8	3	4	2	8	3	1	12	20	11	72
Fresno	35	42	76	32	66	32	6	91	147	148	675
Los Angeles-Long Beach	42	29	46	27	93	22	8	74	171	147	659
Oxnard-Simi Valley-Ventura	43	47	56	18	107	34	12	92	131	145	685
Sacramento	52	44	58	28	87	40	10	100	151	119	689
Salinas-Seaside-Monterey	61	37	53	21	94	31	7	83	135	117	639
San Bernardino-Riverside-Ontario	48	50	38	20	100	23	6	83	148	150	666
San Diego	47	42	60	31	113	40	20	84	150	123	710
San Francisco-Oakland	62	38	88	42	107	53	17	77	185	131	800
San Jose	62	33	66	36	119	41	14	89	139	131	730
Santa Barbara	68	40	72	27	125	40	17	109	115	128	741
Stockton	63	48	66	29	66	47	7	78	136	124	664
Vallejo-Fairfield-Napa	45	43	52	23	68	40	6	105	149	127	658
Modesto	73	53	73	30	79	28	9	117	146	133	741
Santa Rosa	48	39	58	26	63	42	11	97	151	143	678
Santa Cruz	50	48	42	10	80	32	12	95	115	107	591
State Totals	847	657	960	430	1503	577	177	1469	2314	2131	6347

6630 total hires.

14.5
#3 - 14% of total hires

#1

#2

Table XII

Respondents' Rating of EDD Effectiveness

Area	Good	Satisfactory	Unsatisfactory	Of No Value	Other Comments	No Response	Total
Anaheim-Santa Ana-Garden Grove	15	26	33	100	32	355	561
Bakersfield	1	7	0	11	4	38	61
Fresno	16	26	27	95	40	365	569
Los Angeles-Long Beach	20	45	16	81	32	355	549
Oxnard-Simi Valley-Ventura	17	37	24	100	50	341	569
Sacramento	26	44	15	86	43	348	562
Salinas-Seaside-Monterey	33	53	23	73	41	299	[illegible]
San Bernardino-Riverside-Ontario	20	46	14	89	41	346	556
San Diego	21	37	9	96	46	352	561
San Francisco-Oakland	30	33	25	86	36	394	604
San Jose	23	53	19	91	55	319	560
Santa Barbara	29	64	20	90	35	328	567
Stockton	28	49	21	63	21	349	531
Vallejo-Fairfield-Napa	24	42	19	76	52	330	543
Modesto	32	68	30	89	42	329	590
Santa Rosa	32	37	20	71	39	356	555
Santa Cruz	33	43	12	88	24	281	451
State Totals	400	710	327	1385	634	5485	

STATE OF CALIFORNIA—HEALTH AND WELFARE AGENCY

EMPLOYMENT DEVELOPMENT DEPARTMENT
EMPLOYMENT SERVICES BOARD
CAPITOL MALL, SACRAMENTO, CALIFORNIA 95814
TELEPHONE: (916) 322-2116

January 10 1975

Dear Mr. Employer:

California employers paid $934 million in taxes last year to support unemployment insurance, employment services and benefits provided by the Employment Development Department.

The Employment Services Board is interested in improving the services provided in return for those taxes. For this reason, we ask you to assist us by completing the attached questionnaire and returning it to us in the enclosed envelope.

We assure you that your response will be considered confidential information and will be protected. Data supplied will be tabulated so the sources cannot be identified.

The information you provide us will enable the Board to make recommendations for improvement of the Department's service. Your cooperation is essential to achieve the ultimate goal - BETTER SERVICE TO THE PEOPLE OF CALIFORNIA.

Sincerely yours,

EMPLOYMENT SERVICES BOARD

Fred M. Stewart
FRED M. STEWART
Chairman

Enc

Exhibit 1. ESB Questionnaire

1. Approximately how many people do you presently employ?

_____ (1) Under 50

_____ (2) 50 - 99

_____ (3) 100 - 249

_____ (4) 250 - 499

_____ (5) 500 - 999

_____ (6) 1,000 and over

2. During the last 12 months, the number of people you employed:

_____ (1) was relatively constant

_____ (2) increased somewhat

_____ (3) increased substantially

_____ (4) decreased somewhat

_____ (5) decreased substantially

_____ (6) fluctuated up and down

3. Do you know about the Department's local Community Advisory Committee in your area?

_____ (1) Yes, I know of its activities and responsibilities.

_____ (2) Yes, have heard of it, but do not know of its activities and responsibilities.

_____ (3) No.

[illegible] ons?

_____(1) Poor quality of referred applicants.

_____(2) Very slow service.

_____(3) Excessive calls.

_____(4) Did not fill job orders.

_____(5) Lost personal contact with the field office.

_____(6) Other ______________________________

9. Which of the services offered by the Department's field office have you used during the past 12 months?

_____(1) Placement services.

_____(2) Wage and labor market information.

_____(3) Development and follow-up on OJT contract.

_____(4) Assistance on improving personnel policies and practices.

_____(5) Assistance on Unemployment/Disability insurance claims.

_____(6) Other ______________________________

_____(7) None.

10. During the last 12 months, approximately what percentage of your job openings did you list with the Department's field office?

_____(1) Had no job openings to fill.

_____(2) Up to 10 percent.

_____(3) Up to 25 percent.

_____(4) Up to 50 percent.

_____(5) Up to 75 percent.

_____(6) More than 75 percent.

_____(7) None.

11. During the last 12 months what were the categories of job openings you listed with the Department's field office?

_____(1) Office and clerical.

_____(2) Sales.

_____(3) Maintenance.

_____(4) Production.

_____(5) Professional, technical and managerial.

_____(6) Service.

_____(7) Agricultural.

_____(8) None.

[illegible] age quality [illegible] you during [illegible] the Department's field office was:

_____(1) Excellent.

_____(2) Satisfactory.

_____(3) Unacceptable.

_____(4) No applicants referred.

_____(5) Did not request referrals.

13. What sources did you use during the last 12 months when you hired employees?

_____(1) Department's field office.

_____(2) Company's personnel office.

_____(3) Private agency.

_____(4) Business and technical schools.

_____(5) News media.

_____(6) Union halls.

_____(7) Community agency.

_____(8) Other ______________________________

_____(9) Made no hires.

14. How do you rate the Department's effectiveness in aiding your recruitment efforts?

_____(1) Good.

_____(2) Satisfactory.

_____(3) Unsatisfactory.

_____(4) Of no value.

_____(5) Other comments ______________

GENERAL COMMENTS - Please elaborate on your responses to any of the questions or comment on any experience not covered.

[illegible]:

	Never	Seldom	Occasionally	Frequently
(a) Personal visit	____(1)	______(2)	______(3)	_______(4)
(b) Mail	____(5)	______(6)	______(7)	_______(8)
(c) Telephone	____(9)	______(10)	______(11)	_______(12)

5. What was the purpose of the contact(s) made by the Department's field office during the last 12 months? (CHECK ALL THAT APPLY)

____(1) To explain the services they offer employers

____(2) To solicit job openings.

____(3) To solicit your firm's participation in job training programs.

____(4) To gather labor market information.

____(5) Information on unemployment insurance or disability insurance claims.

____(6) Other ____

____(7) No contacts made.

6. For your firm, what were the results of the contact(s)? (CHECK ALL THAT APPLY)

____(1) Strengthened your relationship with the Department's field office.

____(2) Gave you a better understanding of the Department and the services offered.

____(3) Agreed to participate in a job training program.

____(4) You placed a job order with them.

____(5) The service offered by the Department was of no value to you.

____(6) Other ____

____(7) No contacts made.

7. If you recently started, or increased your use of the services of the Department's field office, which of the following action(s) led to this?

____(1) A visit by a Department representative to explain services offered.

____(2) Received a promotional telephone call.

____(3) Radio or television announcements.

____(4) Received a brochure describing the services offered.

____(5) Read about Department's activities in the newspaper.

____(6) Required to use the Department's services because of government contract(s).

____(7) Recommended by business associate(s).

____(8) Other ____

Business Week
SPECIAL REPORT

STATE AND LOCAL GOVERNMENT IN TROUBLE

How well will the Reagan economic revolution work? Most attempts to answer that question so far have focused on the overall U.S. economy and on the financial markets. But the true test of Reaganomics will come at the state and local level. The President is shifting more of the burden of government away from Washington at a time when the local infrastructure is decaying, when the ability of states and cities to borrow is withering, and when state and local revenues are shrinking. The problems are so severe as to constitute a crisis for state and local government. In the pages that follow, the editors of BUSINESS WEEK document the extent of the crisis and examine its implications for economic growth and for the growing rivalry between regions, as well as its probable political and social impact.

STATE AND LOCAL GOVERNMENTS IN TROUBLE

THE DECAY THAT THREATENS

Reagan's plan to spur business investment could be jeopardized by a lack

While high interest rates have led in recent weeks to doubts over the prospects for President Reagan's economic program, Americans at large still seem to be committed to its central premise—that a revolutionary curtailment of the government's role in the economy should release resources to the private sector and create a new era of noninflationary growth. Vast tax and spending cuts have been passed that are intended as enabling legislation for unleashing the private sector. But in its zeal to put the U. S. back on a fast-growth track, the Reagan Administration may unwittingly have created a barrier to the success of its program.

Falling revenues are now combining with an inability to borrow in a way that is making it extremely difficult for Washington's great partner in the federal system, state and local government, to fill its traditional role of producing the basic government infrastructure for growth—such elementary things as bridges, roads, sewage, water, and mass transit. So serious is the decay of the nation's infrastructure and so poor the prospects for its refurbishment that many sophisticated businessmen and economists believe the U. S. is entering a period of severe crisis for state and local government.

The nation's physical infrastructure is only part of the state and local authorities' problem. Compounding the crisis are cuts in federal funding in the no less important area of human capital—job training, vocational education, and health care. Letting such public services decline could have high costs not only in social and political terms but also in terms of the operating environment for business.

Acceptance of decay

To a nation that has already experienced the virtual bankruptcy of New York City in 1975, the forced reorganization of Cleveland's finances in 1978, and the recurring difficulties of many cities and states, including Michigan and Missouri, in meeting their payrolls, the idea that local governments are once again in dire straits may seem like nothing to get alarmed about. Indeed, as the passage of Proposition 13 in California and similar tax-spending-limitation moves in 18 other states has shown, the American public is sick and tired of paying high local taxes, even if tax relief means accepting a reduction in services and living with potholes in the streets, bridges that are on the verge of collapse, and an interstate highway system that is about 95% complete but already needs $26 billion in repairs.

But the current crisis is far more severe than in the past. For a series of forces is now at work that calls into question the ability of local governments throughout the nation—not only in the traditionally depressed Northeast and Midwest but even in the fast-growing Sunbelt—to provide the infrastructure needed for economic growth. These forces are:

MASSIVE CUTS IN FEDERAL AID TO STATE AND LOCAL GOVERNMENT. After growing almost fourfold in the 1970s, federal grants-in-aid will be drastically reduced, falling from $88 billion in 1980 to $78.6 billion in 1983 (chart).

A REDUCED STATE AND LOCAL TAX BASE. With the cut in federal taxes—especially for business—some 30 states that tie their taxes to federal taxes will face declining revenues.

RECORD-BREAKING INTEREST RATES. The rates that states and cities have had to pay for money have almost doubled since 1977. The average municipality now has to pay 85% of what the U. S. Treasury has to pay for long-term money; only two years ago it was 70%. So prohibitive have borrowing costs become that even such financially sound states as California have recently suspended new bond offerings.

A REDUCTION IN THE ATTRACTIVENESS OF STATE AND LOCAL BONDS. To spur private saving and investment, the Reagan Administration has lightened the tax load, particularly in the upper brackets, and has provided special tax-exempt investment vehicles such as the All Savers certificates and has broadened the scope of Individual Retirement Accounts. This has reduced the attractiveness of tax-exempt municipals to the rich, who have been their traditional purchasers.

The effect of these four forces is to put municipal finance in an unprecedented vise at a time of growing need.

According to the Urban Institute, neglect in maintaining the country's exist-

ECONOMIC GROWTH

of vital state and local facilities

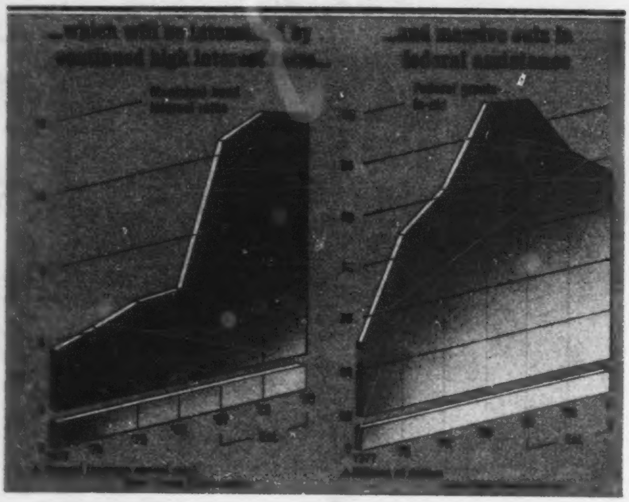
ing infrastructure will push maintenance investment alone to over $660 billion in the next 15 years. This is as much as state and local government has spent on new investment in the past 20 years; it is equal to 20% of the entire U. S. gross national product in 1980.

If state and local government cannot find a way out of this bind, the effects will be devastating. It is perfectly true that the private sector has carried the responsibility for economic growth throughout the history of this nation. But at virtually every stage of the nation's history, growth was dependent on a balance between private and public investment.

The great canal boom of the early 19th century was financed mainly by private sources, but public subsidies provided a favorable investment climate. This was even more true of the railroad boom of the late 19th century. The growth of the nation's great manufacturing centers, with their dense concentrations of population, was dependent on public spending for streets, bridges, and mass transit. The great auto boom of the 20th century could never have occurred without huge public investment in roads and highways. Similarly, the great post-World War II airliner boom was dependent on complementary public investment. There is no reason to believe that this historical necessity for balanced investment has come to an end. So even if, initially, President Reagan's economic program does unleash a surge of private investment, it would be likely to abort if state and local government cannot find the wherewithal to build the public facilities needed for support.

In the past decade, the crisis of state and local government has occurred mainly in the Frostbelt. But it would be a serious mistake to infer that the states of the Sunbelt will therefore be immune to the infrastructure crisis of the 1980s. For just as New York City needs a $5 billion investment in mass transit to prevent a further erosion of jobs and population, Houston needs to invest heavily in new freeways or mass transit in order to prevent the traffic congestion that threatens to strangle its growth.

The crisis of the 1970s became highly visible because some cities and states were hanging by their financial fingernails and had to reduce expenditures sharply and restructure debt. Bankruptcies and near-bankruptcies may also occur during the 1980s. But these lurid financial episodes only serve to worsen the real growth problem. For in the past local politicians have responded to financial stress by postponing the maintenance of existing capital plant and deferring the building of new plants, much the same way an executive in the private sector acts when his company is in a financial bind. Says New York State Comptroller Edward V. Regan, "You can always delay public investment, but in the end it catches up with you."



A wave of anxiety

The Reagan Administration argues that, until now, a good part of the infrastructure crisis has been the result not of insufficient spending but of inefficient, wasteful spending. It maintains, for example, that subsidies to mass transit are not cost-effective and that the sewage-treatment program, which cost $3.4 billion in 1980, is in need of overhaul. It believes that federal spending for roads should be confined to major highways essential for national defense. These arguments reflect the Administration's basic philosophy that more and more federal functions should be shifted to state and local government. And the Administration maintains that it has taken a large step in that direction by consolidating 57 separate federal programs into 9 new or modified categories of block grants.

Although many state and local officials may have welcomed the added flexibility in the way they can spend federal money, the Reagan-imposed austerity, particularly the proposed second round of budget cuts, is now stirring a wave of anxiety among local officeholders, including many key Republican governors and mayors. They fear that the states and cities have been set adrift, because there may simply not be enough money from any source. They say that Reagan's new federalism has assigned them a role that they plainly do not have the resources to fill. As a consequence, a desperate hunt is on for new ways for cities and states to raise revenues and to increase the borrowing power needed to attack the infrastructure crisis. But no one thinks funding solutions will be easy.

INFRASTRUCTURE: A NATIONWIDE NEED TO BUILD AND REPAIR

For years cities and states have neglected their basic life support systems. Voters demanded more policemen and teachers and a cap on transit fares; timely road repair and bus maintenance seemed less important. And politicians readily complied with the voters' priorities and neglected their local infrastructures. When they did spend money for investment, they favored new structures over repairs: a picture of a ribbon-cutting was surely worth more votes than one of a sewer line being replaced. This strategy may have gotten politicians reelected, but it left the infrastructure to crumble.

Recently, however, growing numbers of bursting water mains, flooding basements, creaking bridges, collapsing roads, and stalling buses have awakened the public and elected officials alike to the problem of the deteriorating infrastructure. Yet the Reagan Administration's $35 billion first-round budget cuts and proposed $13 billion second round, coming when the municipal capital markets are in chaos, could prevent this new awakening from being translated into effective action. If that occurs,

Spreading urban stress: In New York, a collision on the deteriorating subway system and a water-main break; and a traffic jam in Houston, which could become paralyzed without mass transit.

the result would be supremely ironic. For the economic expansion Reagan is predicting requires a strong and healthy public infrastructure. Industry cannot expand without adequate water and sewage systems and well-maintained roads, bridges, and mass transit systems to get its employees to work and its goods to market.

Says Pat Choate, author of *America in Ruins* and currently an economist at TRW Inc.: "I don't want to sound like the Joe Granville of public works, but the fact is that much of America's infrastructure is on the verge of collapse." The problem is so widespread, he says, that "three-quarters of America's communities can't participate in Reagan's economic growth program."

The decay is evident in all parts of the nation's stock of public capital:

STREETS AND HIGHWAYS. More than 8,000 mi. of the interstate highway system's 42,500 mi. and 13% of its bridges are now beyond their designed service life and must be rebuilt. And just to maintain current service levels on the roads and highways outside urban areas that are not part of the interstate system will require more funds for rehabilitation and reconstruction during the 1980s—over $500 billion—than all levels of government spent on all public works investments during the 1970s.

BRIDGES. It will cost $41.1 billion to replace or rehabilitate the more than 200,000 deficient bridges—two out of every five—in the nation.

SEWERS. To meet existing water pollution control standards, federal and local governments will have to invest more than $31 billion in sewer systems and wastewater treatment plants over the next five years.

WATER. The 756 urban areas with populations over 50,000 will have to spend up to $110 billion over the next two decades just to maintain their water systems. Even more money will be required to develop more water sources for fast-growing areas in the Southwest and West.

MASS TRANSIT. Spurred by the Administration's proposed elimination of operating subsidies and other pressures, up to one-quarter of the country's 300 metropolitan transit systems might have to cease operation by 1985. The New York City Transit Authority must raise $5 billion to rebuild its rusty, dilapidated rail and bus systems. Chicago's system raised its fare to 90¢ from 60¢ this year, and scheduling, maintenance, and financial problems still abound.

Deterioration of the infrastructure hurts growth because its costs must be borne by America's businesses. U. S. Steel Corp. is losing $1.2 million per year in employee time and wasted fuel rerouting trucks around the Thompson Run Bridge, in Duquesne, Pa., which is posted for weight restrictions because it is in such disrepair. Companies wanting to locate in certain parts of downtown Boston must bear the additional cost of a sewage holding tank to avoid overloading the system in peak hours. And companies in Manhattan lose $166 million a year for each additional five-minute delay on the subways and buses.

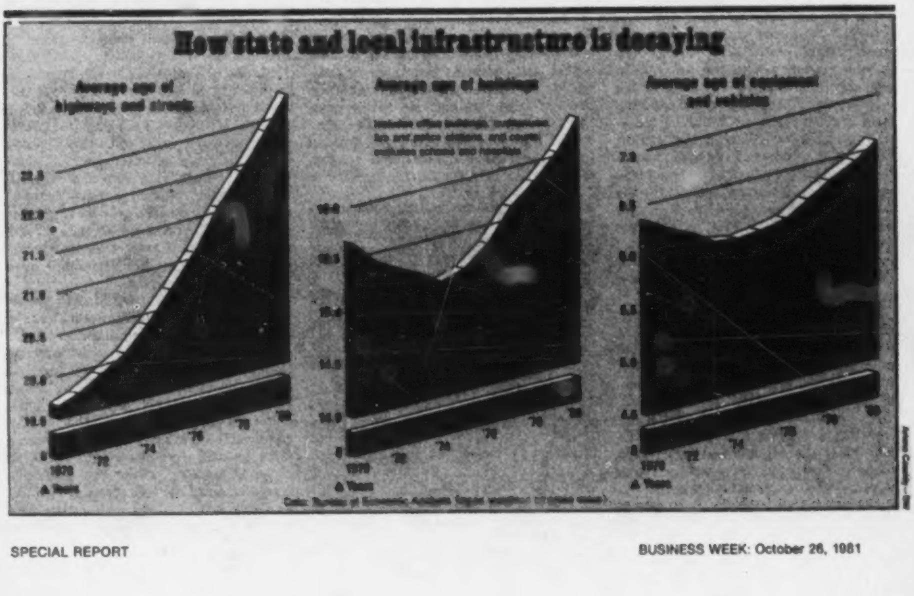
In real terms, Reagan's first-round budget cuts represent a 25% reduction in state and local aid, and a substantial part of that will come straight out of spending for roads, bridges, mass transit systems, and sewers. Moreover, there is a danger that these first-round federal cuts will induce state and local governments to shift their own funds to services and out of infrastructure. And while Reagan's second round of cuts—12% across the board—is being resisted by Congress, there is little doubt that the final result will be to shrink even further the money available for upkeep of local public capital.

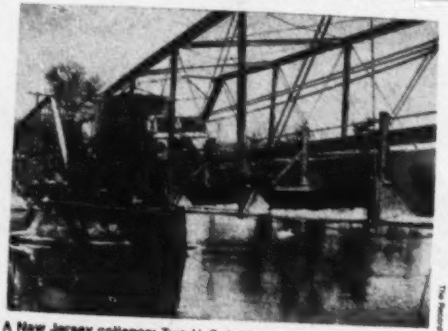
Not only older cities

The blow these cuts will deal to older cities will be especially severe, for that is where the problems are most advanced. Financially strapped New York City must spend $40 billion to repair and rebuild its 6,000 mi. of streets, 6,200 mi. of sewers, the 775 bridges it owns, and the 1.5 billion gal.-per-day water system. Cleveland needs $124 million to rehabilitate more than 40 of its 490 bridges. And Chicago is seeking $3.3 billion—half from the feds—over the next five years to rehabilitate everything—roads, bridges, sewers, and mass transit.

But even cities in the Sunbelt, which

How state and local infrastructure is decaying





A New Jersey collapse: Two U. S. bridges in five need repairs.

have newer physical plants and rapidly expanding tax bases, face problems with their infrastructures. Fast-growing Dallas must raise some $700 million for water and sewage treatment facilities over the next decade and more than $109 million to repair deteriorating streets. And booming Denver has begun informally delaying its repair and maintenance schedules.

Obviously youth and growth do not guarantee sound and adequate infrastructures any more than age and stagnation necessarily condemn the physical plant to decay. Maintenance, management, and revenues explain why Cincinnati's infrastructure is stronger than Cleveland's and why the bridges run by the Port Authority of New York & New Jersey are better kept than those controlled by New York City. And sophisticated maintenance management is why Dallas' infrastructure, while not perfect, is in better shape than most.

The lack of maintenance has inflicted severe damage on the roads, bridges, and mass transit systems that form the lifeline of the nation's business. Bad roads and bridges keep some 25% of America's communities out of the growth business, says Choate. Even the relatively new interstate highway system is spotted by dilapidation. The federal government, which did not provide funds for "the three Rs"—resurfacing, restoration, and rehabilitation—until 1976, blames the states for failing to keep the highways in good repair. The states complain of the federal government once again saddling them with the responsibility of maintaining whatever Washington builds. The Reagan approach is to take most of its overall cuts in funds for secondary and urban roads and to use them for the interstate program, which will require $53.8 billion through 1990 to complete and repair. This would leave the states and localities to bear the entire cost of local roads. The federal government now pays 75% of that.

This proposed retreat from aid for local roads means that the potholes that already dominate many local roads will only proliferate. In New York City, where street repair slowed to a near-standstill in the late 1970s, streets, which engineers say have about a 25-year life, are being replaced at a 700-year rate; the replacement rate is 49 years in Cleveland, 50 years in Baltimore, and 100 years in Oakland.

The deterioration of the mass transit systems that move people to and from work has been even more profound. Nowhere is this more evident than in New York City. The Metropolitan Transportation Authority of the State of New York "literally stopped preventive maintenance in 1975," when the city's fiscal crisis hit, says City Council President and MTA board member Carol Bellamy. The results were stark: The number of serious breakdowns en route rose to 12,291 in 1977 and tripled to an estimated 36,000 this year; and the number of miles traveled by the average subway car before having to be laid up for major repairs dropped from 13,627 in 1977 to 6,500 in 1981.

The MTA's plans to borrow some $5 billion to rebuild its system have been set back by high interest rates and will suffer further from Reagan's proposed cuts, which could reduce capital aid by $30 million and operating assistance by $165 million over three years, forcing higher taxes or a 15¢ fare increase, to 90¢, says Steve Polan, special counsel at the MTA. And if the rebuilding is delayed, transit failures will choke the economic vitality of the region even further.

The irony in Reagan's cuts is that the growth he is predicting cannot take place without adequate water, sewage, and transit

In Massachusetts, federal operating subsidies will decline $13 million in fiscal 1982 and $28 million more over the next two years. "The first third that goes we can cope with," says James F. Carlin, Massachusetts' Transportation Secretary. "But when the cuts go up to $20 million, we could have some problems." One of their problems will be caused by Conrail's consolidation, which will leave the communities in the southeast of the state without service. "The state is going to have to come in and acquire the railways and then get some carrier to come in and run those lines," explains Carlin.

Since fast-growing cities in the Sunbelt have avoided reliance on federal help for their still small transit systems, the cuts will not hurt them as much. The Metro bus system in Houston does not use federal money for operating expenses, so it will not be affected immediately by any budget cuts. Most of the federal money for two bus maintenance facilities has already been committed. And work on contraflow lanes and raised tracks for buses will continue with local money. Nevertheless, Houston's plans to develop a rail line to link southwest Houston with downtown will be slowed, even though the city will continue to fund engineering studies with some $10 million in local taxes.

The vital connections

Similarly, Dallas, which has been slow in reacting to the need for a sophisticated system, is now faced with bearing the full burden of financing its future mass transit needs unless the state helps. Although the voters just last year rejected the establishment of a regional transportation authority, mass transit, like sewers, is vital for growth. If growth continues at its present rate, without the development of a mass transit system, cities like Dallas and Houston could eventually be paralyzed.

Inadequate and dilapidated sewer lines and wastewater treatment plants are also stalling economic activity both in stagnating cities that have to bring their systems up to congressionally mandated standards and in growing areas that need additional capacity. Wastewater treatment plants in 47% of the communities surveyed by the Commerce Dept. in 1978 were operating at 80% or more of capacity, while the generally accepted effective full capacity utilization rate is 70%. That means that new plants and homes could not be hooked up to those systems. The Florida Environmental Protection Dept., for example, recently prohibited Orlando, one of the fastest-growing areas in the U. S., from adding more homes to its overloaded sewer system. The moratorium was lifted only when Orlando signed court decrees promising to build more sewage treatment plants.

If the Administration's plans for distributing treatment plant funds go through—it wants to limit funds to the cities' needs as of 1980—Orlando and other growing cities and suburbs will have to build capacity for new population without federal money. Capital spending for wastewater treatment facilities by all levels of government has tripled since the Clean Water Act was passed in 1972, making it the largest single public works program now under way. The Administration wants to cut the estimated remaining federal costs for treatment plants to $24 billion from $90 billion. And Reagan would slice annual federal expenditures from $3.5 billion to $2.4 billion.

Water and the West

If Reagan's changes become law, there will be less money to spend overall, but changes in the allocation formula will benefit some cities and cost others. It could end up penalizing growing areas and helping older cities. Baltimore, for example, needs to spend nearly $1.5 billion, or $1,880 per capita, to get its sewers and waste treatment system in shape, according to estimates by the U. S. Environmental Protection Agency. With current levels of federal aid, it has been spending around $35 per capita per year, according to the Washington-based Urban Institute, which has made a major study of infrastructure needs. Reagan's proposals are expected to give Baltimore more money. But in the Chicago area, where the sewer systems overflow raw sewage into homes and lakes and rivers alike with a disturbing regularity, the Metropolitan Sanitary District is less likely to get the funds it wants to build a $3.4 billion, 131-mi. "deep tunnel" to upgrade its system. It has already sunk $1.2 billion into pollution control and will probably have its flood control moneys slashed by Washington.

Reagan's approach could also reduce grants going south of the Mason-Dixon Line and west of the Mississippi. Right now there is little concern among local officials, partly because the spending requirements to meet standards on these newer systems are low: $3 per capita for Tulsa, Tucson, San Jose, and Dallas.

But over the long run the cuts could create problems. Houston is receiving 75% federal matching funds for a large sewage plant, which the city needs to meet federal clean water standards. Once that is spent, City Controller Kathryn J. Whitmire does not expect any more federal funds. "If we don't have federal assistance, we'll finance as much as is feasible through revenue bonds based on user fees," she says. "But for large additional projects, we'll have to turn to the developers; we've already seen developers ready to participate." But some experts point out that this will raise the cost of new construction, and that could slow growth.

Huge investments also will be required in water systems over the next two decades to maintain economic vitality. "The history of much of the West is the history of its water projects," says Choate. "And water will determine its future." The water systems in much of the West have not been well maintained, and they will require additional spending in the 1980s. Since the federal government does not support local water systems, Reagan's cuts will have no direct impact. But where water is controlled by cities instead of independent authorities, the cuts in other areas could force politicians to divert funds that would normally go to maintain the water system, and that could increase problems in the future.

Even cities in the Sunbelt, with newer physical plants and rapidly expanding tax bases, delay repairs and curtail services

In the East, too, money will have to be spent on water, but there the problem is storage, treatment, and distribution. "One half of the water lines are so decrepit that they need to be replaced," says Choate. New York City, for example, loses 100 million gal. of water per day because of leaks.

The squeeze on state and local governments is not coming only from Reagan's austerity push. Even while federal capital aid is being slashed, court-mandated improvements in jail conditions are requiring many cities and states to upgrade their prisons. "If the federal government doesn't give the local governments and states the money for jail and prison construction," says Susan Walters, an infrastructure expert at the Council of State Planning Agencies, "the trend of mandating jail replacement by the judiciary means that streets, water systems, and schools will go."

Cities and states are scrambling to find ways to buffer their infrastructures from these revenue shortfalls. One approach being considered by cities that still control their sewers and water supplies and other facilities is to turn these over to independent operating authorities that have pricing and bonding power. Experts have noted that, since they have their own revenue sources, the authorities' maintenance programs have been insulated from the fiscal squeeze that has led many municipalities to skimp on maintenance. They "generally maintain their capital plants better and have healthier financing," says Urban Institute economist George E. Peterson. "There's not a pothole in the George Washington Bridge," says Peter C. Goldmark Jr., executive director of the Port Authority of New York & New Jersey, the largest multipurpose operating authority in the U. S. "We resurfaced it two years ago." The City of New York, by contrast, has so neglected maintenance on the Manhattan Bridge that it must sharply limit traffic there for several years while it rebuilds.

A long recovery

Yet independent authorities have their drawbacks: Every time one is set up, it limits the flexibility of the government to shift funds to meet its most pressing priorities. There is no way city officials can subsidize street repair out of water fees, for example, if the water system is operated by an independent authority. Says Peterson, head of UI's infrastructure study: "If you generalize that model so every service has its own financing and operating authority, it eliminates all trade-offs between services. How far can you go?"

The crisis in America's infrastructure has been building for decades, and its resolution will take decades. "This is not a crisis for the short-winded," says former New York City Budget Director David A. Grossman. "Most rebuilding will take a decade or decade and a half," adds TRW's Choate. Yet even with such a long horizon, there is no doubt that the cuts Reagan has made and the cuts he has proposed portend a major setback to the rebuilding of America's infrastructure.

BORROWING GETS HARDER AS THE DEMANDS INTENSIFY

Historically among the best credit risks in the financial markets, the state of California approached Wall Street underwriters this September with plans for a $100 million bond issue for parks and water cleanup. The plan looked almost boringly routine in an era when state and local issuers tap the debt markets for amounts approaching $1 billion at a crack and use the money for things as offbeat as building fast-food restaurants. But California financial planners were in for a rude shock. Interest rates leaped beyond the state's self-imposed statutory limit of 11% for public debt—effectively shutting the state out of the bond market. The borrowing still has not been done.

California is not alone. States and cities across the country are facing a borrowing crunch of unprecedented dimension, because of their inability or unwillingness to pay high enough interest rates. Local governments have issued about $2.5 billion in stopgap, short-term notes this year in anticipation of retiring them when they can again bring bonds to market. The amount of bonds authorized but unissued is at least three times that, according to securities industry estimates—bringing the total of bonds held back to about $10 billion.

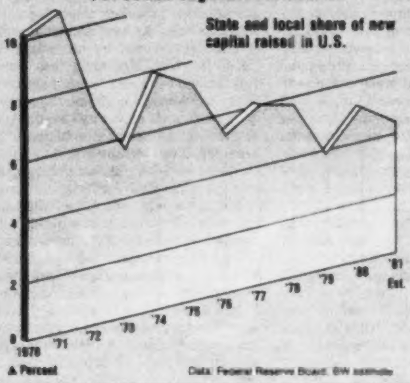
All in all, the combination punch of high interest rates and blocked borrowing will mean more financial pressure on states and cities at a time when they can least afford it because of the sharp federal cutbacks in aid. Debt service as a percentage of total expenditures will rise for those that can borrow, local governments' credit ratings will erode, and they will be forced to resort more and more to short-term financing, which will make long-term planning for upwards of $700 billion in capital needs in the 1980s all but impossible.

In New York, the state legislature has approved $600 million in borrowing power for the New York City subway system, but State Comptroller Edward V. Regan says that the borrowing "is out of the question" so long as rates for 20-year municipal bonds are as high as 12.73%, the current average yield. In Massachusetts, Development Secretary Byron J. Matthews says: "I can't think of one project in the state that has moved forward under a general capital improvement bond for the last several months," and Boston has been virtually shut out of the long-term bond market because of its own fiscal problems. Chicago cannot float notes for its transit system, and even Denver, a high-growth city in a booming region, is holding back $19 million in bonds for water system improvements.

The amount of long-term bonds issued in the tax-exempt municipal market (encompassing states, cities, and all local and regional agencies) this year is expected to register the largest drop in a decade, from $48.3 billion to about $41 billion. More important, the amount of that financing used to meet basic infrastructure needs, such as waterworks, sewers, transportation, and schools, has been about $10 billion a year for more than a decade. The other $30 billion or so goes to areas not crucial to local governments' basic mission—for example, construction for private industry, financing for single-family housing, and building power plants for use by the private sector.

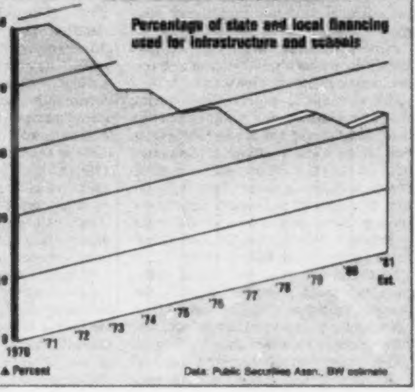
With competition in the tax-exempt market increasing, states and cities have witnessed an unprecedented erosion in their credit ratings. Except for a technical change within one grade level, downgradings in credit ratings by Moody's Investor Services have exceeded upgradings this year for the first time in at least a decade. This means even higher

States and cities are being crowded out of the capital markets ...



Data: Federal Reserve Board, BW estimate

... and using their borrowed money less to meet basic needs



Data: Public Securities Assn., BW estimate

Daniel Langelier — BW

rates for many issuers and, ultimately, more fiscal problems.

"I'm terribly worried about the state of the municipal market," says James J. Lowrey, a New York-based adviser to municipal issuers. Lowrey predicts that the insolvency or near-insolvency in places such as New York City, Chicago, and Cleveland in recent years may be repeated again and again elsewhere as cities find both their revenues and available credit squeezed.

Eventually, the logjam of pent-up borrowing demand should break; financing for critical infrastructure such as waterworks and mass transit cannot be put off forever. But state and local borrowers who do venture into the long-term markets are finding that the days of deep-discount money—at rates substantially below the private sector's borrowing costs—are gone. Indeed, the tax-exempt rates paid by state and local borrowers for long-term bonds have recently exceeded 80% of the cost of comparably rated taxable corporate bonds—far higher than the 65% historical standard.

Vying with the big boys

The spread has narrowed because of fundamental changes in investor preferences and federal tax policy, which go far beyond the cyclical trend of higher interest rates. Even if interest rates moderate, the structural changes in demand for state and local debt, generally referred to as municipal bonds, or "munis," will have serious implications for the ability of local governments to raise capital.

Until now, their borrowing problems have attracted little attention. Indeed, on the surface, the muni market appears to be booming. Although states' and cities' long-term financing is down this year, it still exceeds corporations' long-term borrowing, and individual investor demand is robust. But the future of the municipal bond looks bleak.

The municipal market's most fundamental problem is simply that the supply of available credit is not keeping up with borrowers' demands. Salomon Bros. credit sage Henry Kaufman says that municipalities face "crowding out" from the long-term capital markets by the huge borrowing needs of the federal government, widely expected to total $50 billion in the fourth quarter alone.

"National policy now . . . pits states and municipalities squarely against the economy's most powerful borrowers, the federal government and large business corporations," says Kaufman. "In this kind of struggle, state and local governments cannot win." Corporations and the federal government, Kaufman contends, can virtually "raise money at will" in the markets, although they may have to pay more, while local issuers are fettered by interest rate ceilings, voter referendums, legislative authorizations, and political pressures.

Although annual municipal borrowing has risen by $20 billion in the past 10 years, it has not kept up with inflation. Net new capital raised by states and localities has fallen sharply as a percentage of the entire U. S. capital markets (chart, page 154)—a trend that can only be intensified in the future by the federal government's soaring borrowing needs.

A less apparent trend is what Kaufman calls "crowding in"—the rapid growth in the use of tax-exempt bonds to finance projects that have little to do with traditional state and city responsibilities. The most controversial of the nontraditional borrowing uses has been tax-exempt industrial development bonds (IDBs). Although Congress restricted IDBs in 1969, state-authorized development agencies are still allowed to act as issuers of tax-exempt bonds to finance private industry construction—the ostensible public purpose being the jobs and economic growth thereby created. In the past five years states have eagerly jumped on the IDB bandwagon, paying little heed to the competition that these issues provide for the general financing done by local governments.

Matthews of Boston, which has been virtually shut out of long-term bonds: Nationwide, that market is expected to show its biggest drop in a decade this year.

President Reagan has vowed to curb such bonds, and Administration sources hint that they will seek to end the tax exemption on interest on issues of under $10 million, which have financed a string of McDonald's restaurants, K mart stores, and even a topless bar in Pennsylvania. That still leaves tax-exempt IDBs of more than $10 million for a list of quasi-private purposes—pollution-control additions to industrial plants, for instance—that account for perhaps 25% of all long-term municipal financing.

"The major question for this decade in public finance is who will get the tax-exempt money—the local hamburger chain or the local highway system," says Ronald Forbes, head of the Municipal Finance Study Group of the State University of New York at Albany. The Denver Water Board's finance director, Robert E. Wiedemann, bemoans the proliferating uses for tax-exempt bonds. "Anytime you have more of something, it's going to drive up the interest rates," he says. But issuing IDBs is one of the few things that states can do, short of direct tax abatement, to attract business. "We're willing to let the federal government make some tough [budget] decisions that will have an impact on the states," says Governor Christopher S. "Kit" Bond of Missouri. "But now it seems that they're trying to take it away on the borrowing end." Bond is especially upset about a recent Internal Revenue Service ruling that individual municipalities could not escape the $10 million small-issue ceiling by lumping together smaller issues in one offering.

No matter what the fate of IDBs, state and local governments will still find themselves competing for credit against powerful, independent public authorities whose borrowings are also jamming the market. One of these, the Washington Public Power Supply System (WPPSS), has recently become the largest single issuer of tax-exempt debt. Ironically, while most independent authorities have been strong borrowers because their bonds were secured by user fees, WPPSS is having colossal problems that threaten the entire municipal market.

Construction delays and cost overruns at two of five nuclear power plants WPPSS is building have become severe, and the authority has found the bond markets closed to these two projects. A state commission seems close to winning approval for mothballing the project for 30 months, but bondholders will be left in the lurch—uncertain of whether the authority can be bailed out or return to the markets in time to meet debt service after 1983.

Owing in part to investor apprehensions about the authority, WPPSS paid a record 15% when it borrowed in the bond market for its three less-troubled plants in September. "This kind of thing has a ripple effect," says one municipal bond dealer. "The WPPSS rate drives up everybody else's rate—particularly an issuer in Washington." Indeed; Moody's dropped the state of Washington's bond rating a notch on Oct. 7, which could drive up the cost of a planned one-year note offering by $1 million. Moody's cited revenue shortfalls, but bond dealers feel the fears of state liability for WPPSS also may have been an ingredient in the downgrading.

The crowning blow

The Reagan Administration has dealt a severe, if unintended, blow to the municipal bond with its new tax policies. Interest from municipal bonds is, of course, free of federal income tax. But with personal income taxes scheduled for a 23% reduction by 1984, individual investors have that much less reason to seek tax-exempt income. The reduction from 70% to 50% in the top rate for unearned income, moreover, means that interest from competing investments, such as high-yielding money market mutual funds, will also be taxed less for many investors, and there is more incentive to seek capital gains in common stocks or real estate.

For many municipal issuers and dealers, the crowning blow came with the authorization of the new, tax-free All Savers certificate. Because the one-year deposits will compete directly with municipal debt of equal or similar maturity, dealers and issuers alike fear that interest costs will be driven up significantly. The Municipal Finance Officers Assn. estimates that states and cities will pay up to an extra $1.1 billion in finance costs in the first year of All Savers, and they are lobbying hard to prevent the program's renewal after that. Says Michigan's deputy budget director, Douglas Roberts: "Nobody's going to buy [our] notes below the 12.1% [All Savers] rate." Adds Paul R. Thompson, finance director of Detroit: "All Savers drives another nail in the coffin of the tax-exempt market for municipalities."

The Reagan-instilled disincentives to municipal investment come at a time when the market is depending more and more on individuals to soak up municipal paper. Individuals, who have historically bought about 25% of all new municipal issues, have increased their share of the buying to between 50% and 75% in 1981, attracted by high yields.

Part of the problem is that institutions such as commercial banks and property and casualty insurers have all but left the market, either because they have found other ways to shelter their profits or because they have little left to shelter. Thus, if the Reagan tax programs make municipal bonds less attractive to individuals, municipalities will have to raise interest rates as an incentive. That means the historic relation between municipal and corporate rates may be skewed for good.

States and cities face paying skyrocketing rates for tax-exempt municipal bonds just when cuts in federal aid start to take hold

"We have legislated away, without knowing it, the subsidy for municipal financing," says Felix G. Rohatyn, chairman of New York's Municipal Assistance Corp., which has helped pull the nation's largest city from the brink of insolvency. "We are raising money at essentially taxable rates, and that's a very fundamental change. Even if the rates come down in general, municipal rates will stay at a par with taxable ones."

Rohatyn adds that "we could never have brought New York City back to fiscal health under the financing conditions prevailing today"—words with a foreboding ring for cities that are struggling to get back on their feet. "New York had its crisis early," he says. "But for cities like Cleveland, Chicago, Detroit, St. Louis, Buffalo, and Philadelphia, there will be worse troubles in the 1980s."

With the pressures building, states and cities are resorting to more short-term debt and a host of "creative financing" gimmicks. Issues of debt obligations maturing in less than one year are expected to be about $30 billion this year, a record 42% of the total. The city of Columbus, Ohio, and the state of Connecticut have broken ground by issuing tax-exempt commercial paper—a trend likely to be picked up elsewhere. In one issue, New York's MAC gave bond buyers the option to buy more bonds at fixed interest rates in the future—desirable to investors if interest rates go down. And the state of Washington planned to sell $400 million in one-year notes on Oct. 15, giving buyers the option to sell them back at face value after a month—desirable to investors if interest rates go up.

The impact of a default

In one of the most innovacive new financing plans, New York City's Metropolitan Transportation Authority (MTA) intends to sell buses and rail cars to investors and then lease them back for system use. The plan allows the MTA to put up only 80% of the cost of the new equipment, with the investors supplying the remaining 20%—in effect cutting the system's borrowing demands for capital expenditures.

But these may be nothing more than desperation moves. "Local issuers can never rely on short-term obligations for capital projects—and that's the bulk of their borrowing need," says Salomon's Kaufman. These projects require advance cost knowledge, for the long haul, which short-term notes do not provide. Options granted on bond issues can backfire, depending on interest rate movements. Equipment leasing remains subject to IRS scrutiny and may have limited applications outside urban transit. "The reason I fear for municipal issuers is that they really don't have a wide range of financing choices available to them," says Kaufman.

Most serious of all, credit market analysts now believe that the chances for a default by a major municipal issuer—the WPPSS, for instance—are as high as they have been since New York City's euphemistic "moratorium" on interest payments in 1975. The fact that investors have always looked upon the municipal bond as one of the safest investments would only serve to increase the shock value of a failure. If such a default came without warning, it could frighten lenders to the point of holding back credit in general—to corporations and individuals as well—with an unfathomably adverse impact on the economy.

A REVENUE SQUEEZE LEADS TO STOPGAP SOLUTIONS

Reductions in federal grants to state and local governments are coming at a time when many cities and states are already financially strapped and facing slow growth or even declines in revenues from other sources. Revenue losses are not a new problem for many cities, particularly the older ones in the Northeast and Midwest. Indeed, the rate of growth in state and local receipts from all sources during the 1970s slowed to less than half the rate during the 1960s. For the 1980s, the Reagan Administration's cutbacks will intensify this already developing trend and place increasing pressure on the nation's cities to find the wherewithal to continue to provide basic public services for their residents while financing economic and community development.

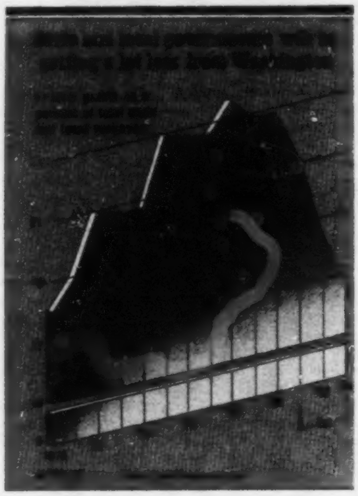
Although grants to cities and states represent only 14.2% of the federal budget, they are the target of one-third of the Administration's sweeping budget cuts. Funds for these programs have been slashed by 14% for fiscal 1982—25% after inflation—and the Administration's new program to contain the deficit threatens a further 12% reduction. Even excluding the latest proposal, by 1983 revenue dependency on Washington will have dropped 28% from the peak in 1978 (chart).

Localities will be forced to pick up the greatest slack in the area of social services, where more than half of the total budget reductions for fiscal 1982 will hit two broad functions. Income security and health programs, including food stamps, child nutrition, medicaid, Aid to Families with Dependent Children (AFDC), and Trade Adjustment Assistance, will lose about $13 billion. Programs for education, training, and employment, such as the Comprehensive Employment & Training Act and public service employment, will be cut by about $7 billion. In addition, the responsibility for administering many of these programs will be transferred to the local level from the federal government.

Although most of Reagan's cuts are in social services, they will nevertheless have a devastating effect on the infrastructure. The reason is that, while local politicians want to boost infrastructure spending, they find unemployment, loss of income, and loss of city services even more devastating politically. If the Reagan crunch comes, says Executive Deputy Mayor Rudy Nothenberg, the city's chief financial officer, then San Francisco's first priority would be its "defense department"—that is, police and fire protection—public transportation, and the municipal hospital for the indigent, even if that meant skimping on infrastructure repair. In New York City, too, Reagan service cuts could cost the infrastructure dearly. "Our first priority, if the cuts go through, must be the life-support services: police, fire protection, health services, and transit operations," says City Comptroller Harrison J. Goldin. "The infrastructure would have to be allowed to deteriorate even further—which would be disastrous."

The effect of these revenue losses across the various areas of the country is regionally neutral, according to an April, 1981, report by the Office of Management & Budget. However, in a private study, Andrew J. Moody, director of metropolitan forecasting at Chase Econometric Associates, concludes: "The impact of the Administration's budget cuts will vary considerably across states and will depend upon the type of programs that are cut." If that is true, some cities could be hit hard—particularly in the highly urbanized and older industrialized states in the Mid-Atlantic, New England, and East North Central regions.

To cope with these losses, city officials face a limited set of traditional revenue-raising alternatives. In the current climate of fiscal restraint, politicians are reluctant to advocate higher taxes, and many cities do not have taxing authority. Most cities have tax limitations that preclude new tax revenues. Moreover, many states, such as Michigan and Ohio, are financially hard pressed themselves and are unable or unwilling to offer cities much relief. Because approximately 30 states "piggyback" their tax rates to the federal tax structure, the Administration's new tax cuts mean less revenue for those states. Accelerated depreciation and other tax-exempt income, such as that from All Savers certificates, will cut further into state coffers.



Adjustment will be particularly difficult for the older cities in the Northeast and Midwest where revenue growth has suffered from a declining industrial base that has gradually eroded the area's tax base along with the credit ratings of some of the major cities (table, page 163). Cleveland, which lost 23% of its population in the 1970s and defaulted on its debt in 1978, is a prime example. The city expects to lose nearly $30 million for infrastructure repair and millions more for community development projects, and Cuyahoga County will forfeit an additional $40 million for a number of welfare programs, 60% to 70% of which goes to Cleveland residents. Cleveland officials are concerned about the long-term impact. "While the city today is in a strong financial position, we are not able to pick up the cutbacks in social and welfare programs," says William J. Reidy, Cleveland's finance director. Currently, the unemployment rate among the city's black teenagers is about 60%, according to Larry A. Retallick, executive vice-president of the Urban League of Greater Cleveland, and he fears that conditions may be ripe for unrest.

In Boston, the federal cuts fail on top of the revenue-slashing effects of Proposition 2½, approved last November, which reduced property taxes to 2½% of fair market value, cut the automobile excise tax by 50%, and gave renters a state tax exemption equal to half of their annual rent. Property taxes were the major source of revenues for the city, and losses resulting from Proposition 2½ will amount to $100 million this year out of a budget of about $1 billion. Now the federal cutbacks will trim a further $50 million, mostly from economic development projects and employment training programs.

In an effort to make do with less, David S. Mundel, Boston's intergovernmental relations director, says the city has developed three basic strategies. First, it is continuing to finance the most efficient programs. Second, it is attempting to bolster charitable contributions and now requires many job-training programs to get matching funds from private industry. Finally, the city has proposed a variety of increases in taxes and fees, such as a boost in parking-violation rates and a condominium-conversion tax. This third route might prove fruitless, however, because any changes in city taxes require state approval, and Governor Edward J. King has vowed to veto any tax increases. Mundel adds that there is a general misconception that budget cuts will trim only the fat and sloth out of public service. "But given the size of these cuts," he says, "we're forced to do less." Mundel notes that there is a basic difference between what Boston and the federal government are experiencing: The federal government is only slowing down its rate of growth, he says, but Boston is actually growing smaller.

Newer cities hurt, too

While the problems will be most acute in the older cities, newer areas also will feel the revenue bite. Because of the federal cuts, state tax relief, and a sluggish economy, Colorado will barely manage a balanced budget this year after expecting a $144 million surplus. As a result, the state will not be able to replace the $155 million in federal cuts to various state and local agencies. Infighting has begun because Colorado's inability to help Denver has exacerbated state vs. local tensions. City officials argue they should not have to bear the entire burden of providing health care, museums, a zoo, and other cultural facilities to people who come to Denver from all over the state. "We are going to have to live with these kinds of arguments on a continuing basis," says Randy W. Harrison of the Colorado Commission on State & Local Government Finance. Denver officials are choosing to raise user fees in an effort to regain revenues and make the problems more visible to the public. As of Oct. 1, for instance, an out-of-city resident must pay $100 for a library card.

Many cities in Texas and other energy-rich Southwestern and Mountain states, which receive payments from energy-severance taxes, are in a better position to adjust to the loss of federal money, but that does not mean the cuts will go unnoticed, particularly in social services. Statewide, Texas has lost $40 million in funding for social programs, and the Dallas-Fort Worth area alone has forfeited $7 million. According to William E. Buchanan of the Texas Human Resources Dept., 53,000 people in Dallas-Fort Worth will be forced off AFDC, and 175,000 will be dropped from the food stamp program.

These and other problems that state and local governments are experiencing in adjusting to the Administration's cutbacks cast doubts on the success of the White House's block-grant programs. The Administration plans to consolidate the funding for a number of similar categorical programs into broad block grants while giving states the responsibility to administer the programs and to spend the money as they see fit. But it will not be that easy.

First, the states have fewer federal funds to handle the increased responsibility. Second, states complain that the promised flexibility to spend the money as they wish is not there. And third, the cities are concerned that they will get lost in the allocation shuffle and that worse, not better, relations with state governments will result as municipalities fight for their share.

Chicago's Budget Director F. Tim Witsman worries about the state and local bureaucracy that might grow up around the block grants. "I am not opposed to the notion of block grants, but I am opposed to them going through the states. That is a contradiction of philosophy, layering a new level of bureaucracy on top," he says. Witsman fears that administration costs might eat away money the city could use. George A. Athanson, mayor of Hartford, Conn., foresees cities fighting states and inner-city groups fighting city hall. "Meanwhile," he says, "Reagan will be sitting at Camp David saying, 'Isn't it wonderful, our national government is not interfering.' "

Indeed, Bernard L. Weinstein, professor of economics at the University of Texas at Dallas, believes that the cutbacks will profoundly change the relationship between federal and state governments and, in particular, between the states and the cities. "My major concern," he says, "is that Washington has pushed this stuff without thinking about what the responsibility of each level of government should be. Who should do what?"

City officials from both North and South also express concern that the Reagan cuts will create more problems than they will solve. Many view the transfer of federal responsibilities to cities that are ill-equipped to handle the new burden as merely a shift of the financial stress on the federal government to the cities, and many feel that the Administration has moved too far too fast.

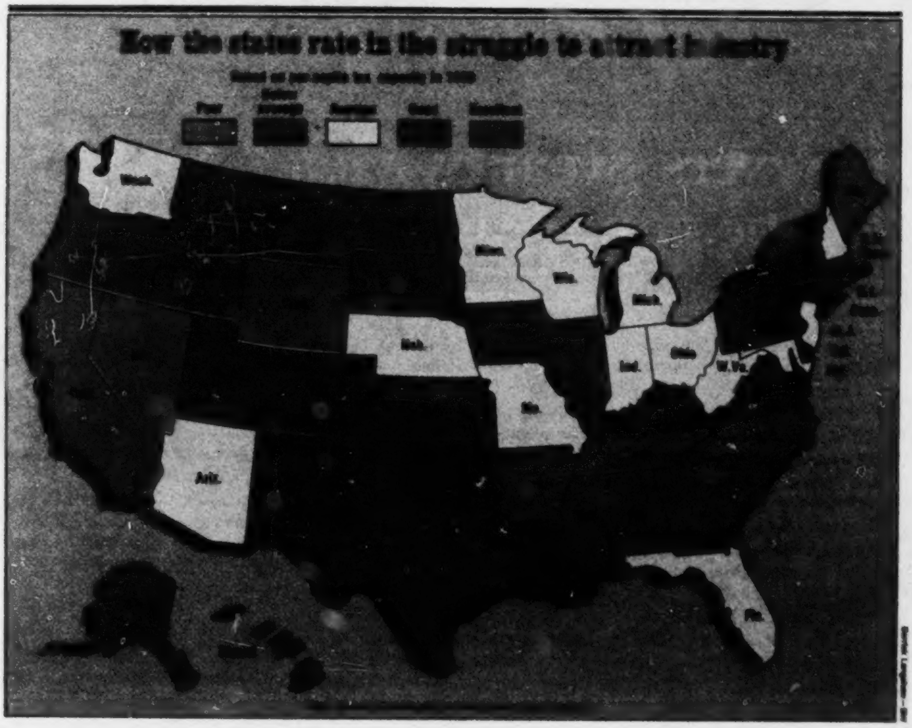
"We are undertaking a major federal policy without understanding its impact on the cities," says Anita A. Summers, adjunct professor at the Wharton School of the University of Pennsylvania. Summers emphasizes that this impact depends crucially on the untested axioms of supply-side economics. "If the supply-side theory does not work, then I think the Northeastern cities will receive a severe blow, if not a mortal blow," she maintains.

NOW ENERGY IS WHAT COUNTS IN THE WAR BETWEEN STATES

President Reagan's economic policies may, in the long run, revitalize the U. S. economy and bring new fiscal health to the states of the Northeast and Midwest. But for the time being those policies will intensify the war between the energy-rich and energy-poor states. While that war has some of the characteristics of the Sunbelt vs. Frostbelt fights of the 1970s, neither the alignments nor the issues are the same. Some Sunbelt states, notably Florida, have developed typically Northern urban problems, while such frosty places as Wyoming and, above all, Alaska, are rolling in energy wealth. The growing importance of energy will change the nature of the intensifying competition among states for industry and jobs.

Without access to federal government funds and a relatively weak tax base, even many states of the Old South, which had been able to attract industry from the Northeast and Midwest with generous tax-forgiveness incentives, will find themselves at a disadvantage. Like the states in the Frostbelt, they can ill afford to give up tax revenues if they no longer have Washington financing to help with building roads, sewers, and basic facilities. Energy-rich states do not have to worry about such trade-offs since they have abundant revenues.

The Administration and representatives of the energy-poor states, mainly those concentrated in the Midwest and Northeast, have engaged in a heated argument about whether the Reagan tax and budget cuts discriminate among regions. The Office of Management & Budget has published a study arguing that the benefits of tax reductions and the pain of budget cuts are evenly distributed around the nation. But Representative Carl D. Pursell (R-Mich.), chairman of the bipartisan Northeast-Midwest Congressional Coalition's budget task force, counters: "If you look at what is happening in the distribution


How the states rate in the struggle to attract industry

of dollars in the budget, there's a major transfer of money to the Sunbelt."

Regardless of who is right, some states are much better equipped than others to offset federal spending cuts with state funds. The massive runup in energy prices since the mid-1970s has greatly increased the disparity in the fiscal capacity of states. Energy producers dominate the list of states with the largest and fastest-growing per capita tax bases (map, page 166), according to a comprehensive measure of income developed by the staff of the Advisory Commission on Intergovernmental Relations.

Taxes and decontrol

Last year, seven states received more than 20% of their revenues from severance taxes levied on the production of minerals, mainly oil, gas, and coal. A decade ago, only one state—Louisiana—relied so heavily on energy taxes. Severance taxes, which range as high as Montana's 30% levy on coal, have become a major bone of contention in interstate relationships. The Midwest Governors Conference estimates that residents of its 13 member states paid $700 million in severance taxes to other states in 1979 and will pay more than $2.5 billion in 1985.

Accelerated decontrol of natural gas prices, which the Administration will soon recommend, will exacerbate the situation. The Northeast-Midwest Institute, the research arm of the congressional coalition, estimates that, with decontrol, severance tax receipts will total $280 billion through this decade. "Nothing scares us more right now than natural gas decontrol," says Rhode Island Governor J. Joseph Garrahy. The 13 Midwestern governors, 11 of whom are Republicans, recently voted unanimously to oppose immediate decontrol of natural gas.

The energy-consuming states also feel that severance taxes put them at a disadvantage in attracting and keeping business and jobs. While they are being forced to raise taxes to make ends meet and are running the risk of driving employers away, the energy producers are able to rely on revenue sources that do not increase the cost of doing business in their states. "It's going to become apparent that Texas, Louisiana, and Montana, for example, are using their energy revenues competitively," says Representative Barber B. Conable (R-N. Y.), ranking Republican on the House Ways & Means Committee.

The energy-poor states, which find themselves squeezed between Washington's budget cuts and what they view as rapacious tax policies by energy-producing states, are bent on retaliation. At their August meeting, the Midwestern governors set up one task force to study a "soil-depletion tax," in effect a severance tax on food production, and another to consider how the region's abundant water resources could be used to squeeze money out of the water-poor West. "The fear is that we're going to get into a war with the energy-rich states," says Rhode Island's Garrahy. "You'll have states coming up with all kinds of schemes to tax each other, and it will be bloody murder."

Consuming states are attempting to stop energy-rich states from imposing severance taxes. Earlier this year, the Supreme Court denied a bid by Commonwealth Edison Co. in Chicago, joined by several state and local governments, to have Montana's coal tax declared an unconstitutional restraint on interstate commerce. But in its decision, the court made it clear that Congress, if it wished, could restrict the states. A number of bills have been introduced in Congress to do just that, although the prospects for passage are bleak. Another idea gaining force is a federal severance tax with the proceeds earmarked for expanded revenue sharing. "I don't see anything else that will reduce the threat," says Tom Cochran, executive director of the Northeast-Midwest Institute. But many state and local politicians, looking at the federal government's own fiscal plight, are dubious about any new money coming from Washington, despite Reagan's promise to return revenues to the states. "As sure as we're talking, the only way we'll see anything returned is with equal or greater budget cuts," says Maryland House of Delegates Speaker Benjamin Cardin, a Baltimore Democrat.

The South's rise does not mean the old problems of regional disparity have disappeared. Northerners say they have just been redistributed

Faced with their limited ability to get directly at severance taxes, many consuming states are looking for ways to grab their share of the oil bounty. Last year, New Jersey imposed a special tax on petroleum refiners, while New York and Connecticut attempted to levy gasoline excise taxes that could not be passed through to retail buyers. All three taxes were struck down by the courts. New York is trying to redraft its tax to meet the legal requirements, while Connecticut is considering taxing oil companies on a share of their total profits rather than just their income earned in the state.

The common problems of energy-consuming states are pushing them into joint efforts. Such long-standing regional blocs as the Midwest Governors Conference are becoming more assertive. Regional congressional groups, such as the New England Congressional Caucus, are stepping up their activities. Florida Governor Robert Graham is pushing for a Southern "common market" to coordinate regional taxation and development policies. The New England Energy Conference is negotiating for Canadian gas and hydroelectric power. The Midwestern governors are planning a similar agency both to negotiate for their energy needs and to develop the region's coal and grain resources as synthetic fuel feedstock.

Harsh political realities

But these regional arrangements can do no more than nibble at the edges of the problem. Politicians from energy-consuming states believe that solutions must begin with the federal government. And they see precious little sign that the Reagan Administration is interested in addressing the issue.

"Our major problem is in getting the federal government to recognize that there is a problem," says Senator David Durenberger (R-Minn.), chairman of the Senate subcommittee on intergovernmental relations. "There are people in the White House who think that all the problems of regional disparity have been solved because the South is going to rise again."

Faced with these harsh political realities, the energy consumers are reduced to fighting a rearguard action against measures that will make their problems worse. The one thing they are dead set against is any further transfer of federal responsibilities to states without a corresponding shift of revenues, and this bodes ill for Reagan's latest budget-cutting proposals. "If we turn back more responsibility for welfare to the states, we'll have a world-beater of a problem," says Durenberger. "Every state just does not have the fiscal capacity to pick up the cost."

STATE AND LOCAL BUDGETS BECOME A BRAKE ON GROWTH

President Reagan's program of fiscal austerity is putting many state and local governments in what economists regard as the worst of all worlds: that of having to cut spending and raise taxes at the same time. Such policies are a double whammy for both business and consumers. Higher taxes, of course, discourage consumers from buying and business from investing. And cutbacks in state and local government spending, which totaled $355 billion in 1980, will simply mean less demand for many goods and services.

The growing fiscal squeeze on state and local governments will further reduce that sector's role as a major source of economic growth. Borne by the baby boom and the spread of suburbia, state and local government spending in the postwar period grew by leaps and bounds in response to the demand for roads, bridges, schools, hospitals, water, and sewage treatment—as well as police and fire protection and social services. Spending by state and local government far outpaced that of the overall economy for almost 25 years, and by 1975 it accounted for 15% of gross national product.

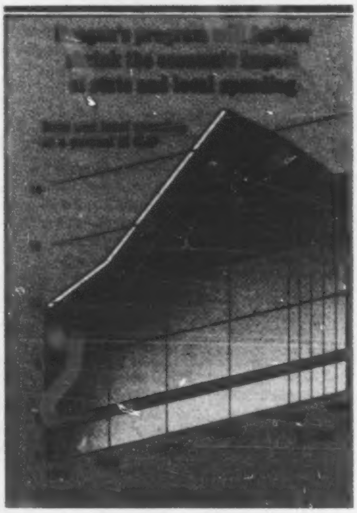
That trend was brought to an abrupt halt during the 1974-75 recession. The importance of the state and local sector in the economy has been shrinking since the mid-1970s as stagflation has cut into the growth of real incomes and the public has demanded lower taxes and fewer services. Reagan's fiscal austerity, which will cut Washington aid to state and local governments heavily, is expected to accelerate that trend (chart).

Both monetarist and supply-side advisers of Reagan argue that this will have little impact on the economy because the reduction of the state and local sector will free resources for the private sector. The resurgence of capital investment and business activity in general caused by reining in government will more than offset the cuts in spending, in their view. And an analysis by the Office of Management & Budget in April concluded that the cuts in state and local government spending would not prevent the economy from hitting the Administration's growth targets.

Weighing the importance of government spending is, of course, a major unresolved issue among economists. Traditional Keynesians such as George Perry of the Brookings Institution believe that it is very important. "The reduction in state and local spending—the result of cutbacks in federal spending—constitutes one of the things that is contributing to an emerging recession," he says.

A political dilemma

But even many conservative economists maintain that the cutbacks in state and local government spending will have some impact on overall economic growth, at least in the short run. As Rudolph Penner, of the American Enterprise Institute, put it in a recent article: "There is a great deal of controversy as to whether one dollar of grants provokes more or less than one dollar of state and local expenditures, but there is no doubt that total spending rises as a result of the grant system." Federal grants to state and local government will drop by about $10 billion over the next three years under Reagan's program. Washington aid will also be cut back substantially in other areas.



The dilemma for many states and local governments is that it will not be easy politically to cut many services. In some areas, such as education, where demand is weakening because of the end of the baby boom, further restraint will be relatively easy. Most economists agree that a major factor influencing the growth of state and local spending in the postwar period has been the need to "educate the baby," as Penner puts it. But spending on education has slowed dramatically in the last decade as the baby boom was absorbed, and demographics indicate that this trend should continue at least for much of this decade.

The shift to an older population that began in the 1970s and is expected to continue into the 1990s, could, however, have an equally dramatic impact on the demand for other state and local government services. In the past decade the fastest-growing areas of state and local government spending have been for health care, including hospital construction, and for social and other welfare services. This has been in large part a response to the enormous growth in the 65-and-over age group. But these are also some of the services hit hard by the Administration's cuts.

At the same time, the transformation of the baby boom generation into young adults is expected to keep the demand for housing strong, even though it is in a depression now because of high interest rates. Even if much of the new housing is multifamily and built in older suburbs, as many economists believe, the demand for accompanying police and fire protection and administrative services, also among the fastest-growing in the past decade, is likely to continue. But in many services needed to support housing, such as aid for sewers, roads, and water installations, Washington aid is being slashed. And this reduction is taking place at a time when such vital underpin-

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nings are in a rapid state of decline.

The business community as a consumer of state and local government services will also be hurt by such cutbacks. "State and local governments account for about 85% of capital construction, often with government aid, and that is going to shrink," notes Manuel Carballo, a lecturer on public policy at Harvard University. "Yet already sewers, roads, water systems are in a very sad state of repair. Things that businessmen rely on as staples are going to be jeopardized."

Offsetting the benefits

The business community, as well as the young adults and the older population, have considerable political clout. Politicians around the country are already finding themselves in the uncomfortable position of having to cut popular services or raise taxes. Conservative Republican Governor John Rhodes has stirred up a political storm in Ohio's Republican-controlled state senate by proposing to raise taxes to avoid a budget deficit.

A great number of economists believe that states and cities will have no choice but to raise taxes. Many are prohibited by law from running deficits, and it is increasingly difficult for almost all state and local governments to borrow in the financial markets.

As American Enterprise Institute's Penner put it in his article: "It may seem implausible to assume that total tax burdens will be increased rapidly in an era that is supposed to be characterized by new conservatism and virulent tax revolts. In particular, it may be quite unreasonable to assume that the state and local sector will grow rapidly relative to net national product when so many states are passing constitutional limits on tax rates and spending. Yet the recent history of New York State and New York City has taught us that it is not difficult to get around constitutional limits, and at the federal level President Carter felt it permissible to recommend in his 1981 budget one of the largest tax increases in recent peacetime history."

There is little chance that Reagan will back off the recent tax cuts, which are the centerpiece of his whole program. But increases in state and local government taxes will certainly offset some of the benefits of federal tax cuts. And if the end result of the efforts of state and local governments to cut some spending while maintaining or increasing others is a net decline in outlays, as many economists believe, the combination will have a significant impact on overall economic growth.